

November 2011

2. Sitzung IFRS-FA vom 14.02.2012
02_06d_IFRS-FA_Re-ED_RR_BC_01_04d

Basis for Conclusions
Exposure Draft ED/2011/6

A revision of ED/2010/6 Revenue from Contracts with Customers

Revenue from Contracts with Customers

Comments to be received by 13 March 2012

**Basis for Conclusions on
Exposure Draft
Revenue from Contracts
with Customers**

Comments to be received by 13 March 2012

ED/2011/6

This Basis for Conclusions accompanies 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), using the 'Comment on a proposal' page.

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

The IASB, the IFRS Foundation, the authors and the publishers do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

Copyright © 2011 IFRS Foundation®

ISBN for this part: 978-1-907877-39-1

ISBN for complete publication (set of three parts): 978-1-907877-37-7

All rights reserved. Copies of the draft IFRS and its accompanying documents may be made for the purpose of preparing comments to be submitted to the IASB, provided such copies are for personal or intra-organisational use only and are not sold or disseminated and provided each copy acknowledges the IFRS Foundation's copyright and sets out the IASB's address in full. Otherwise, no part of this publication may be translated, reprinted or reproduced or utilised in any form either in whole or in part or by any electronic, mechanical or other means, now known or hereafter invented, including photocopying and recording, or in any information storage and retrieval system, without prior permission in writing from the IFRS Foundation.



The IFRS Foundation logo/the IASB logo/'Hexagon Device', 'IFRS Foundation', 'eIFRS', 'IAS', 'IASB', 'IASB Foundation', 'IASCF', 'IFRS for SMEs', 'IASS', 'IFRIC', 'IFRS', 'IFRSs', 'International Accounting Standards', 'International Financial Reporting Standards' and 'SIC' are Trade Marks of the IFRS Foundation.

Additional copies of this publication may be obtained from:
IFRS Foundation Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@ifrs.org Web: www.ifrs.org

CONTENTS

*from paragraph***BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT
REVENUE FROM CONTRACTS WITH CUSTOMERS**

INTRODUCTION	BC1
BACKGROUND	BC3
Why make the change?	BC15
Alternative revenue recognition models	BC17
Basis for recognising revenue	BC18
Basis for measuring revenue	BC26
SCOPE	BC29
Definition of a contract	BC32
Definition of a customer	BC36
Exchanges of products to facilitate a sale to another party	BC38
Contracts outside the scope of the proposed requirements	BC40
Contracts partially within the scope of other standards	BC44
IDENTIFYING THE CONTRACT	BC47
Combination of contracts	BC51
Contract modifications	BC55
IDENTIFYING PERFORMANCE OBLIGATIONS	BC62
Definition of a performance obligation	BC62
Marketing incentives, incidental obligations and perfunctory obligations	BC64
Identifying separate performance obligations	BC67
Attributes of a distinct good or service	BC73
Bundles of goods or services	BC77
Pattern of transfer	BC81
SATISFACTION OF PERFORMANCE OBLIGATIONS	BC82
Control	BC83
Developing the notion of control	BC85
Applying the notion of control	BC87
Performance obligations satisfied over time	BC89
Performance creates or enhances an asset that the customer controls as it is created	BC90
Performance does not create an asset with an alternative use to the entity	BC92

The customer simultaneously receives and consumes benefits as the entity performs	BC96
Another entity would not need to substantially re-perform the work completed to date	BC97
The entity has a right to payment for performance completed to date	BC100
Performance obligations satisfied at a point in time	BC104
Measuring progress	BC113
Output methods	BC117
Input methods	BC121
Reasonable measures of progress	BC123
MEASUREMENT OF REVENUE	BC124
Determining the transaction price	BC127
Variable consideration	BC131
Time value of money	BC143
Non-cash consideration	BC157
Consideration payable to the customer	BC159
COLLECTIBILITY	BC163
Recognising revenue at the amount to which the entity expects to be entitled	BC167
A separate recognition threshold	BC168
Presentation of the effects of a customer’s credit risk	BC171
Credit risk in contracts with a financing component that is significant to the contract	BC174
ALLOCATING THE TRANSACTION PRICE TO SEPARATE PERFORMANCE OBLIGATIONS	BC176
Estimating stand-alone selling prices	BC178
Residual approach	BC181
Specifying a hierarchy of evidence	BC183
Allocating discounts and contingent consideration	BC186
Allocating discounts	BC190
Allocating contingent consideration	BC192
Contingent revenue cap	BC193
CONSTRAINT ON THE CUMULATIVE AMOUNT OF REVENUE RECOGNISED	BC198
Determining when the amount of revenue recognised is reasonably assured	BC202
ONEROUS PERFORMANCE OBLIGATIONS	BC204

Unit of account	BC206
Scope of the onerous test	BC208
Identifying when a performance obligation is onerous	BC211
Measurement basis	BC214
Presentation of the liability for onerous performance obligations	BC216
CONTRACT COSTS	BC217
Costs of fulfilling a contract	BC217
Incremental costs of obtaining a contract	BC222
Amortisation and impairment	BC227
Learning curve	BC230
PRESENTATION	BC235
Relationship between contract assets and receivables	BC239
DISCLOSURE	BC243
Disclosure objective	BC246
Materiality	BC247
Disaggregation of revenue	BC249
Reconciliation of contract balances	BC254
Disclosure of remaining performance obligations	BC261
Performance obligations	BC267
Onerous performance obligations	BC268
Assumptions and uncertainties	BC269
Assets from the costs to obtain or fulfil a contract	BC271
Disclosures required for interim financial reports	BC272
APPLICATION GUIDANCE	BC274
Sale of a product with a right of return	BC275
Product warranties and product liabilities	BC280
Warranties that are separate performance obligations (service-type warranties)	BC286
Warranties that are not performance obligations (assurance-type warranties)	BC289
Principal versus agent considerations	BC294
Customer options for additional goods or services	BC296
Allocating the transaction price	BC298
Renewal options	BC300

Customers' unexercised rights (breakage)	BC305
Licensing and rights to use	BC310
Repurchase agreements	BC317
A forward or a call option	BC318
A put option	BC321
Accounting for repurchase agreements in which the customer does not obtain control of the asset	BC324
TRANSITION, EFFECTIVE DATE AND EARLY ADOPTION	BC326
Transition	BC326
Effective date and early adoption	BC332
BENEFITS AND COSTS	BC336
CONSEQUENTIAL AMENDMENTS	BC345
Sales of assets that are not an output of an entity's ordinary activities	BC345
Transition for first-time adopters of IFRSs	BC350
ALTERNATIVE VIEW	
APPENDICES:	
Summary of changes from the 2010 exposure draft	
Amendments to the Basis for Conclusions on other IFRSs	

Basis for Conclusions on the exposure draft Revenue from Contracts with Customers

This Basis for Conclusions accompanies, but is not part of, the [draft] IFRS.

Introduction

- BC1 This Basis for Conclusions summarises the considerations of the International Accounting Standards Board (IASB) and the US national standard-setter, the Financial Accounting Standards Board (FASB) in developing the exposure draft for revenue (and some costs) from contracts with customers. It includes the reasons for accepting particular views and rejecting others. Individual Board members gave greater weight to some factors than to others.
- BC2 This Basis for Conclusions discusses the following matters:
- (a) background (paragraphs BC3–BC28);
 - (b) scope (paragraphs BC29–BC46);
 - (c) identifying the contract (paragraphs BC47–BC61);
 - (d) identifying performance obligations (paragraphs BC62–BC81);
 - (e) satisfaction of performance obligations (paragraphs BC82–BC123);
 - (f) measurement of revenue (paragraphs BC124–BC162);
 - (g) collectibility (paragraphs BC163–BC175);
 - (h) allocating the transaction price to separate performance obligations (paragraphs BC176–BC198);
 - (i) constraint on the cumulative amount of revenue recognised (paragraphs BC198–BC203);
 - (j) onerous performance obligations (paragraphs BC204–BC216);
 - (k) contract costs (paragraphs BC217–BC234);
 - (l) presentation (paragraphs BC235–BC242);
 - (m) disclosure (paragraphs BC243–BC273);
 - (n) application guidance (paragraphs BC274–BC325);
 - (o) transition, effective date and early adoption (paragraphs BC326–BC335);

- (p) benefits and costs (paragraphs BC336–BC344); and
- (q) consequential amendments (paragraphs BC345–BC351).
- (r) *[This subparagraph in the FASB exposure draft is not used in the IASB exposure draft].*
- (s) *[This subparagraph in the FASB exposure draft is not used in the IASB exposure draft].*

Background

- BC3 The IASB and the FASB initiated a joint project to improve the financial reporting of revenue under International Financial Reporting Standards (IFRSs) and US generally accepted accounting principles (GAAP). The boards decided that their existing requirements on revenue needed improvement for the following reasons:
- (a) US GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions, which can result in different accounting for economically similar transactions.
 - (b) the two main revenue standards in IFRSs have different principles and can be difficult to understand and apply to transactions beyond simple transactions. In addition, IFRSs have limited guidance on important topics such as revenue recognition for multiple-element arrangements. Consequently, some entities that apply IFRSs refer to parts of US GAAP to develop an appropriate revenue recognition accounting policy.
 - (c) the disclosures required under both IFRSs and US GAAP are inadequate and lack cohesion with the disclosures of other items in the financial statements.
- BC4 The boards decided to eliminate those inconsistencies and weaknesses by developing a comprehensive revenue recognition model that would apply to a wide range of transactions and industries. The boards decided that this approach would also improve IFRSs and US GAAP by:
- (a) providing a more robust framework for addressing revenue recognition issues;
 - (b) improving comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;

- (c) simplifying the preparation of financial statements by reducing the number of requirements to which entities must refer; and
 - (d) requiring enhanced disclosures to help users of financial statements better understand the amount, timing and uncertainty of revenue that is recognised.
- BC5 In December 2008, the boards published for public comment the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers* and received more than 200 comment letters in response. In the discussion paper, the boards proposed the general principles of a contract-based revenue recognition model with a measurement approach based on an allocation of the transaction price. That revenue model was developed after the boards held extensive discussions on alternative models for recognising and measuring revenue (see paragraphs BC17–BC28).
- BC6 Respondents generally supported the objective of developing a comprehensive revenue recognition model for both IFRSs and US GAAP. Most respondents also generally supported the recognition and measurement principles proposed in the discussion paper, which are the basic building blocks of the revenue model. In particular, the discussion paper introduced the concepts of a contract containing performance obligations for the entity to transfer goods or services to a customer and that revenue is recognised when the entity satisfies its performance obligations as a result of the customer obtaining control of those goods or services. Respondents to the discussion paper were mainly concerned about the proposals to:
- (a) identify separate performance obligations only on the basis of the timing of the transfer of the good or service to the customer—respondents commented that this would be impractical, especially when many goods or services are transferred over time to the customer (for example, in construction contracts).
 - (b) use the concept of control to determine when a good or service is transferred—respondents asked for clarification of the control concept to avoid the implication that the proposals would require completed contract accounting for all construction contracts (ie revenue is recognised only when the customer obtains legal title or physical possession of the completed asset).
- BC7 The boards considered those comments when developing the exposure draft *Revenue from Contracts with Customers* (the FASB's exposure draft was a proposed Accounting Standards Update), which was published in June 2010. Nearly 1,000 comment letters were received from a wide

range of industries, including construction, manufacturing, telecommunications, technology, pharmaceutical, biotechnology, financial services, consulting, entertainment, energy and utilities, freight and logistics, and industries with significant franchising operations, such as hospitality and fast food restaurant chains. Some of the concerns raised by those respondents were specific to their industry, but many concerns were shared by respondents across various industries.

- BC8 The boards also received a substantial number of comment letters in response to a question asked by the FASB on whether the proposals should apply to non-public entities. Almost all of those comment letters were from respondents associated with sections of the US construction industry (for example, private construction contractors, accounting firms that serve those contractors, and surety providers who use the financial statements of construction contractors when deciding whether to guarantee that those contractors will meet their obligations under a contract). Those respondents raised concerns about the application of the proposed model to non-public entities. Those issues were discussed separately by the FASB.
- BC9 The boards and their staffs also consulted extensively on the proposals in the 2010 exposure draft. Round-table discussions were held in London (United Kingdom), Kuala Lumpur (Malaysia) and in Norwalk, Connecticut and Palo Alto, California (United States of America). Members of the boards and the staffs also participated in conferences, working group sessions, discussion forums and one-to-one discussions which have been held across all major geographical regions. Targeted outreach to develop and refine the proposals involved representatives from accounting firms, local standard-setters, regulators, users of financial statements, preparers and affected industries (such as the real estate, construction, defence/aerospace, telecommunications, software/information technology, media and pharmaceutical industries).
- BC10 With the exception of many of the responses from non-public entities in the construction industry, most of the feedback from the comment letters and from the consultation activities generally supported the boards' proposal for a comprehensive revenue recognition model for both IFRSs and US GAAP. Moreover, most respondents supported the core principle of that model, which is that an entity should recognise revenue to depict the transfer of goods or services to a customer in an amount that reflects the amount of consideration for those goods or services.

- BC11 Almost all respondents to the 2010 exposure draft indicated that the boards needed to further clarify the operation of the core principle. In particular, respondents were concerned about the application of the following:
- (a) the concept of control and, in particular, the application of the indicators of the transfer of control to service contracts and contracts for the transfer of an asset over time to a customer as it is being constructed (ie a work-in-progress asset); and
 - (b) the principle of distinct goods or services for identifying separate performance obligations in a contract. Many respondents were concerned that the principle, as proposed in the 2010 exposure draft, would lead to inappropriate disaggregation of the contract.
- BC12 Many of those respondents were concerned that those proposals could be difficult to apply consistently across a wide range of industries and may produce accounting outcomes that do not faithfully portray the entity's contracts with customers and the entity's performance under those contracts. Some respondents were concerned that the boards' objective of comparability of revenue recognition practices across industries might be achieved only at the cost of losing the current levels of comparability in the revenue recognition practices within each industry. Consequently, some of those respondents suggested that the boards might need to develop industry-specific guidance or create industry-specific exceptions to the general principles.
- BC13 The boards addressed those concerns during the re-deliberations of the proposals in the 2010 exposure draft. A summary of the changes that the boards made to those proposals is presented in the appendix to the Basis for Conclusions. In many cases, those changes either clarify the boards' intentions in the 2010 exposure draft (either by articulating the proposals differently or by adding guidance) or simplify those proposals. In some cases, the changes have resulted in revised requirements that align more closely with existing requirements or current practice than did the proposals in the 2010 exposure draft.
- BC14 As the re-deliberations of those proposals drew to a close, the boards decided to re-expose the proposed requirements for public comment to provide interested parties with an opportunity to comment on revisions that the boards have made since the 2010 exposure draft was published. The boards decided unanimously that it was appropriate to go beyond

their established due process and re-expose their revised revenue proposals because of the importance of the revenue number to all entities and the desire to avoid unintended consequences in the recognition of revenue for specific contracts or industries.

Why make the change?

- BC15 Some respondents to the discussion paper and to the 2010 exposure draft questioned the need to replace existing requirements on revenue recognition—in particular, those requirements that seem to work reasonably well in practice and provide useful information about the different types of contracts for which they are intended.
- (a) For US GAAP, some questioned whether a new revenue recognition model is necessary because Accounting Standards Update No. 2009-13 *Revenue Recognition (ASC Topic 605): Multiple-Deliverable Revenue Arrangements* has resolved some of the issues that the revenue recognition project set out to resolve. Furthermore, the *FASB Accounting Standards Codification*[®] has simplified the process of accessing and researching existing guidance on revenue.
 - (b) For IFRSs, some indicated that the IASB could improve its existing standards by developing additional requirements on critical issues (for example, multiple-element arrangements) without replacing existing standards.
- BC16 The boards acknowledge that it would be possible to improve many existing revenue recognition requirements without replacing them. However, in the boards' view, even after the changes to US GAAP mentioned above, the existing requirements in IFRSs and US GAAP would continue to result in inconsistent accounting for revenue and, consequently, would not provide a robust framework for addressing revenue recognition issues in the future. Furthermore, amending existing requirements would fail to achieve one of the goals of the revenue recognition project—to develop a common revenue standard for IFRSs and US GAAP that entities can apply consistently across industries, jurisdictions and capital markets. Because revenue is a crucial number to users of financial statements, the boards considered that having a common standard on revenue for IFRSs and US GAAP is an important step towards achieving the goal of a single set of high-quality global accounting standards. Consistently with that goal, the boards noted that existing revenue recognition requirements in IFRSs and US GAAP should not be used to supplement the principles in this [draft] IFRS.

Alternative revenue recognition models

- BC17 During the early stages of the boards' project on revenue recognition, the boards considered various alternative revenue recognition models, including the following:
- (a) the basis for recognising revenue—specifically, whether an entity should recognise revenue only when the entity transfers a promised good or service to a customer (ie a contract-based revenue recognition principle) or when (or as) the entity undertakes a productive activity (which could be an activity that is undertaken only when a contract with a customer exists or regardless of whether a contract exists).
 - (b) the basis for measuring revenue—specifically, whether revenue should be measured at an allocated customer consideration amount or at a current exit price.

Basis for recognising revenue

- BC18 In the discussion paper, the boards proposed a principle to recognise revenue based on the accounting for the asset or liability arising from a contract with a customer. The boards had two reasons for developing a standard on revenue that applies only to contracts with customers. First, contracts to provide goods or services to customers are important economic phenomena and are the lifeblood of most entities. Second, most existing revenue recognition requirements in IFRSs and US GAAP focus on contracts with customers. The boards decided that focusing on (a) the recognition and measurement of that asset or liability and (b) the changes in that asset or liability over the life of the contract would bring discipline to the earnings process approach. Consequently, it would result in entities recognising revenue more consistently than when applying existing standards.
- BC19 On entering into a contract with a customer, an entity obtains rights to receive consideration from the customer and assumes obligations to transfer goods or services to the customer (performance obligations). The combination of those rights and performance obligations gives rise to a (net) asset or (net) liability depending on the relationship between the remaining rights and performance obligations. If the measure of the remaining rights exceeds the measure of the remaining performance obligations, the contract is an asset (a contract asset). Conversely, if the measure of the remaining performance obligations exceeds the measure of the remaining rights, the contract is a liability (a contract liability).

- BC20 By definition, revenue from a contract with a customer cannot be recognised until a contract exists. Revenue recognition could, in concept, arise at the point at which an entity enters into a contract with a customer. For an entity to recognise revenue at contract inception (ie before either party has performed), the measure of the entity's rights must exceed the measure of the entity's performance obligations. That would lead to revenue recognition because of an increase in a contract asset. However, as discussed in paragraph BC26, the boards proposed in the discussion paper that performance obligations should be measured at the same amount as the rights in the contract, thereby precluding the recognition of a contract asset and revenue at contract inception.
- BC21 Hence, in the discussion paper, the boards proposed that revenue should be recognised only when an entity transfers a promised good or service to a customer, thereby satisfying a performance obligation in the contract. That transfer results in revenue recognition because, on satisfying a performance obligation, an entity no longer has that obligation to provide the good or service. Consequently, its position in the contract increases—either its contract asset increases or its contract liability decreases—and that increase leads to revenue recognition.
- BC22 Although, in concept, revenue arises from an increase in a contract asset or a decrease in a contract liability, the boards have articulated the proposed requirements in terms of recognition and measurement of revenue rather than recognition and measurement of the contract. The boards thought that focusing on the timing and amount of revenue from a contract with a customer would simplify the proposed requirements. Feedback from respondents to the discussion paper and the 2010 exposure draft confirmed that view.
- BC23 Nearly all respondents to the discussion paper agreed with the boards' view that, in general, an entity should not recognise revenue if there is no contract with a customer. However, some respondents thought that the boards should instead develop an activities model in which revenue would be recognised as the entity undertakes activities in producing or providing goods or services regardless of whether those activities result in the transfer of goods or services to the customer (ie regardless of whether a performance obligation is satisfied). Those respondents reasoned that recognising revenue over time, for example, throughout long-term construction or other service contracts, regardless of whether goods or services are transferred to the customer, would provide users of financial statements with more useful information.

BC24 However, the boards noted the following concerns about an activities model:

- (a) revenue recognition would not be based on accounting for the contract—in an activities model, revenue arises from increases in the entity's assets such as inventory or work-in-progress, rather than only from rights under a contract. Therefore, conceptually, an activities model does not require a contract with a customer for revenue recognition, although revenue recognition could be precluded until a contract exists. However, that would result in revenue being recognised at contract inception for any activities completed to that point.
- (b) it would be counter-intuitive to many users of financial statements—an entity would recognise consideration as revenue when the customer has not received any promised goods or services in exchange.
- (c) there would be potential for abuse—an entity could accelerate revenue recognition by increasing its activities (for example, production of inventory) at the end of a reporting period.
- (d) it would result in a significant change to existing standards and practices—in many of those standards, revenue is recognised only when goods or services are transferred to the customer. For example, in IAS 18 *Revenue*, revenue from the sale of a good is recognised when the entity has transferred ownership of the good to the customer. The boards also observed that the basis for percentage of completion accounting in existing standards is similar to the core principle of the proposed requirements.

BC25 Accordingly, the boards did not develop an activities model and they have maintained their view that a contract-based revenue recognition principle would be the most appropriate principle for a general revenue recognition standard for contracts with customers.

Basis for measuring revenue

BC26 In the discussion paper, the boards proposed an allocated transaction price approach to measure performance obligations. Under that approach, an entity would allocate the transaction price to each performance obligation in the contract (see paragraphs BC124 and BC176). The boards rejected an alternative approach to measure performance obligations directly at current exit prices for the following reasons:

- (a) an entity would recognise revenue before transferring goods or services to the customer at contract inception if the measure of rights to consideration exceeds the measure of the remaining performance obligations. That would be a typical occurrence at contract inception because the transaction price often includes amounts that enable an entity to recover its costs to obtain a contract.
 - (b) any errors in identifying or measuring performance obligations could affect revenue recognised at contract inception.
 - (c) a current exit price for the remaining performance obligations would typically not be observable, and an estimated current exit price could be complex and costly to prepare and difficult to verify.
- BC27 Almost all responses to the discussion paper supported the boards' proposal to measure performance obligations using an allocated transaction price approach.
- BC28 The boards also considered in the discussion paper whether it would be appropriate to require an alternative measurement approach for only some performance obligations (for example, performance obligations with highly variable outcomes for which an allocated transaction price approach may not result in useful information). The boards rejected that approach in developing the proposals for the 2010 exposure draft because a common type of contract with customers that has highly variable outcomes would be an insurance contract, which is excluded from the scope of the proposed requirements. The boards decided that the benefits of accounting for all performance obligations within the scope of the proposed requirements using the same measurement approach outweighed any concerns about using that approach for some performance obligations.

Scope (paragraphs 9–11)

- BC29 The proposed requirements would apply only to a subset of revenue as defined in each of the boards' conceptual frameworks—revenue from contracts with customers. Revenue that does not arise from a contract with a customer is not within the scope of this exposure draft and, therefore, is not affected by these proposed requirements. For example, in accordance with other standards, revenue would continue to be recognised from the following transactions or events:

- (a) dividends;
- (b) for IFRSs, changes in the value of biological assets, investment properties and the inventory of commodity broker-traders; and
- (c) for US GAAP, changes in regulatory assets and liabilities arising from alternative revenue programmes for rate-regulated entities. (The FASB decided that the revenue arising from those assets or liabilities should be presented separately from revenues arising from contracts with customers.)

BC30 The proposed requirements do not amend the existing definitions of revenue in each board's conceptual framework. The boards decided that the definition of revenue is a matter for consideration in their joint project on the conceptual framework. However, the IASB decided to carry forward into its proposed requirements the description of revenue from the IASB's *Conceptual Framework for Financial Reporting* rather than the definition of revenue from IAS 18. The IASB noted that the IAS 18 definition refers to 'gross inflow of economic benefits' and the IASB had concerns that some may misread that reference as implying that an entity should recognise as revenue a prepayment from a customer for goods or services. As described in paragraphs BC18–BC25, revenue would be recognised in accordance with the proposed requirements only as a result of an entity satisfying a performance obligation in a contract with a customer. In addition, the FASB decided to carry forward a definition of revenue that is based on the definition in FASB Concepts Statement No. 6 *Elements of Financial Statements*.

BC31 The definitions of a *contract* and a *customer* establish the scope of the proposed requirements.

Definition of a contract (Appendix A)

BC32 The definition of a contract is based on common legal definitions of a contract in the United States and is similar to the definition of a contract used in IAS 32 *Financial Instruments: Presentation*. The IASB decided not to adopt a single definition of a contract for both IAS 32 and the proposed requirements because the IAS 32 definition implies that contracts can include agreements that are not enforceable by law. Including such agreements would be inconsistent with the boards' decision that a contract with a customer must be enforceable by law for an entity to recognise the rights and obligations arising from that contract. The IASB also noted that amending the IAS 32 definition would pose the risk of unintended consequences in accounting for financial instruments.

- BC33 The definition of a contract emphasises that a contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. The boards noted that such an agreement does not need to be in writing to be a contract. Whether the agreed terms are written, oral or evidenced otherwise, 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. Although the contract must be legally enforceable, the boards decided that the performance obligations within the contract could include promises that result in the customer having a valid expectation that the entity will transfer goods or services to them even though those promises are not enforceable. This is discussed further in paragraph BC63.
- BC34 The boards decided to complement the contract definition by specifying (in paragraph 14) the following attributes of a contract that must be present before an entity can apply the proposed requirements. Those attributes are derived mainly from existing requirements:
- (a) the contract has commercial substance—the boards decided to include commercial substance as an attribute of a contract with a customer when they discussed whether revenue should be recognised for non-monetary exchanges. Such transactions have been an area of financial reporting abuse, with entities transferring goods or services back and forth to each other (often for little or no cash consideration), thereby artificially inflating their revenues. Therefore, the boards decided that an entity should not recognise revenue from a non-monetary exchange if the exchange has no commercial substance. The boards decided to describe commercial substance consistently with its existing meaning in other financial reporting contexts, such as existing requirements for non-monetary exchange transactions. Because other types of contracts also could lack commercial substance, the boards decided that all contracts should have commercial substance to be within the scope of the proposed requirements.
 - (b) the parties to the contract have approved the contract and are committed to perform their respective obligations—the boards decided to include those factors as attributes of a contract with a customer because if the parties to a contract have not approved the contract, it is questionable whether that contract is legally enforceable. Some respondents questioned whether oral and implied contracts could meet the requirement that ‘the parties to

the contract have approved the contract', especially if it is difficult to verify the entity's approval of that contract. The boards decided that the form of the contract does not, in and of itself, determine whether the parties have approved and are committed to the contract. Instead, an entity should consider all relevant facts and circumstances in assessing whether the parties intend to be bound by the terms and conditions of the contract. Consequently, in some cases, the parties to an oral or implied contract (in accordance with customary business practices) may have the intent and the commitment to fulfil their respective obligations. In other cases, a written contract may be required to determine that the parties to the contract have approved and are committed to perform under the contract.

The boards also clarified that this attribute is not intended to represent a threshold for recognising revenue if there are concerns about a customer's ability and willingness to pay the promised consideration. The boards decided that those concerns typically relate to the collectibility of the receivable, which is a measurement issue (discussed further in paragraphs BC163–BC175). However, if there is significant doubt at contract inception about the collectibility of consideration from the customer, that doubt may indicate that the parties are not committed to perform their respective obligations under the contract and thus the criterion in paragraph 14(b) may not be met.

- (c) the entity can identify each party's rights regarding the goods or services to be transferred—this attribute is necessary because an entity would not be able to assess the transfer of goods or services if the entity cannot identify each party's rights regarding those goods or services.
- (d) the entity can identify the payment terms for the goods or services to be transferred—this attribute is necessary because an entity would not be able to determine the transaction price if the entity cannot identify the payment terms in exchange for the promised goods or services. Respondents from the construction industry questioned whether an entity can identify the payment terms for unpriced change orders (ie change orders for which the scope of work may be defined even though the specific amount of consideration for that work has not yet been determined and may not be finally determined for a period of time). The boards clarified that their intention was not to preclude revenue recognition for unpriced change orders if the scope of the work has been approved

and thus the entity has a right to payment for the additional work performed. The boards affirmed that the consideration need not be fixed to identify the payment terms. Hence, the entity would determine the transaction price on the basis of the proposed requirements in paragraphs 50–67.

- BC35 The boards decided that the proposed revenue requirements should not apply to wholly unperformed contracts if each party to the contract has the unilateral enforceable right to terminate the contract without penalty. Accounting for those contracts would not affect an entity's financial position or performance until either party performs. In contrast, there could be an effect on an entity's financial position and performance if only one party could terminate a wholly unperformed contract without penalty. For instance, if only the customer could terminate the wholly unperformed contract without penalty, the entity is obliged to stand ready to perform at the discretion of the customer. And, if only the entity could terminate the wholly unperformed contract without penalty, the entity has an enforceable right to payment from the customer if the entity chooses to perform. In accordance with the proposed requirements, an entity's rights and obligations in wholly unperformed contracts would be measured at the same amount and, therefore, would offset each other. However, by including those contracts within the scope of the proposed requirements, an entity would provide additional information about a change in the entity's financial position that resulted from entering into those contracts. That would involve the entity recognising a liability if a performance obligation in that contract is onerous (in accordance with paragraphs 86–90) or disclosing the amount of transaction price allocated to the remaining performance obligations in that wholly unperformed contract (in accordance with paragraphs 119–121).

Definition of a customer (Appendix A)

- BC36 The purpose of defining a customer is to distinguish a revenue contract from other contracts into which an entity enters. Some respondents asked the boards to clarify the meaning of ordinary activities in the definition of a customer. However, that notion was derived from the existing definitions of revenue. In particular, the IASB's *Conceptual Framework* definition of revenue refers specifically to the 'ordinary activities of an entity' and the definition of revenue in FASB Concepts Statement No. 6 refers to the notion of an entity's 'ongoing major or central operations'. As noted in paragraph BC30, the boards are not reconsidering those definitions in the revenue project.

BC37 When considering the definition of a customer, the boards observed that revenue could be recognised from transactions with partners or participants in a collaborative arrangement. Those arrangements would be within the scope of the proposed requirements only if the other party to the arrangement meets the definition of a customer. Some industry respondents asked the boards to clarify whether parties to common types of arrangements in their industries would meet the definition of a customer. However, the boards decided that it would not be feasible to develop application guidance that would apply uniformly to various industries because the terms and conditions of a specific arrangement may affect whether the parties to the arrangement have a supplier-customer relationship or some other relationship (for example, as collaborators or as partners). Therefore, an entity would need to consider all relevant facts and circumstances in assessing whether the counterparty meets the definition of a customer. Examples of arrangements in which an entity would need to make such an assessment are as follows:

- (a) collaborative research and development efforts between biotechnology and pharmaceutical entities or similar arrangements in the aerospace and defence, technology or healthcare industries, or higher education; and
- (b) arrangements in the oil and gas industry in which partners in an offshore oil and gas field may make payments to each other to settle any differences between their proportionate entitlements to production volumes from the field during a reporting period.

Exchanges of products to facilitate a sale to another party (paragraph 9(e))

BC38 In industries with homogeneous products, it is common for entities in the same line of business to exchange products to facilitate sales to customers or potential customers other than the parties to the exchange. An example is when an oil supplier swaps inventory with another oil supplier to reduce transport costs, meet immediate inventory needs or otherwise facilitate the sale of oil to the end customer. The boards noted that a party exchanging inventory with an entity would meet the proposed definition of a customer because it has contracted with the entity to obtain an output of the entity's ordinary activities. As a consequence, an entity might (in the absence of specific requirements) recognise revenue once for the exchange of inventory and then again for the sale of the inventory to the end customer. The boards decided that outcome would be inappropriate for the following reasons:

- (a) it would gross up revenues and expenses and make it difficult for users of financial statements to assess the entity's performance and gross margins during the reporting period; and
 - (b) some view the counterparty in those arrangements as also acting as a supplier and not as a customer.
- BC39 The boards considered modifying the definition of a customer. However, they rejected that alternative because of concerns about unintended consequences. Therefore, the boards decided to exclude from the scope of the proposed requirements non-monetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers, other than the parties to the exchange.

Contracts outside the scope of the proposed requirements (paragraph 9)

- BC40 The boards excluded from the scope of the proposed requirements three types of contracts with customers that the boards are addressing in other standard-setting projects:
- (a) leases;
 - (b) insurance contracts; and
 - (c) financial instruments and other contracts within the scope of the financial instruments standards.
- BC41 The FASB also decided to exclude from the scope of the proposed requirements guarantees (other than product warranties) that are within the scope of ASC Topic 460 on guarantees. The focus of the existing accounting requirements for those guarantee arrangements relates primarily to recognising and measuring a guarantee liability.
- BC42 Some respondents reasoned that excluding some contracts with customers from the scope of the proposed requirements could perpetuate the development of industry-specific or transaction-specific revenue requirements, which would be inconsistent with the revenue project's stated objective. The boards disagreed with that view. In the boards' view, the proposed requirements would provide them with a framework for considering revenue issues in other standard-setting projects. Any departure from the proposed revenue requirements would arise because the boards have decided that, in the context of those other projects, a different basis of accounting for those contracts with customers would provide users of financial statements with more useful information.

BC43 Many respondents expressed concerns about how the revenue model would apply to construction-type contracts and asked the boards to retain existing requirements for those contracts. The boards discussed those concerns on various occasions with representatives from the construction industry and observed that the concerns were partly attributable to a misperception that the proposals would require completed contract accounting for contracts currently within the scope of IAS 11 *Construction Contracts* or ASC Subtopic 605-35 on construction-type and production-type contracts. In addition, many in the construction industry were concerned about the costs of accounting for a single construction contract as many performance obligations. In the 2010 exposure draft, the boards clarified that not all construction contracts would result in an entity recognising revenue only at completion of the contract. Furthermore, as discussed below, the proposed requirements provide further clarity on identifying separate performance obligations in construction contracts and determining when those performance obligations are satisfied over time. Hence, the boards affirmed their view that the proposed requirements should apply to construction contracts.

Contracts partially within the scope of other standards (paragraph 11)

BC44 Some contracts with customers would be partially within the scope of the proposed requirements and partially within the scope of other standards (for example, a lease with a service). In those cases, the boards decided that it would be inappropriate for an entity to account for the entire contract in accordance with one or another standard because it could result in different accounting outcomes, depending on whether the goods or services were sold on a stand-alone basis or together with other goods or services.

BC45 The boards decided that the proposed requirements should be the default approach for separating a contract and allocating consideration to each part. However, specific issues could arise in separating contracts that are not within the scope of the proposed requirements. For example, a financial instrument or an insurance contract might require an entity to provide services that are best accounted for in accordance with the standards on financial instruments or insurance contracts.

BC46 Therefore, the boards decided that if other standards specify how to separate and/or initially measure parts of a contract, an entity should first apply those requirements. In other words, the more specific standard would take precedence in accounting for a part of a contract. The boards' decision is consistent with the existing requirements on multiple-element arrangements in ASC Subtopic 605-25.

Identifying the contract (paragraphs 12–15)

BC47 In most cases, an entity would apply the proposed requirements to a single contract with a customer. However, the structure and scope of contracts can vary depending on how the parties to a contract decide to record their agreement. For instance, there may be legal or commercial reasons for the parties to use more than one contract to record the sale of related goods or services or to use a single contract to record the sale of unrelated goods or services. The boards' objective in developing the proposed requirements is that the accounting for a contract should depend on an entity's present rights and obligations rather than on how the entity structures the contract. Consistently with that objective, if an entity enters into a contract with a customer that can be renewed or cancelled by either party at discrete points in time, the entity would account separately for its rights and obligations (ie as a separate contract) for each period for which the contract cannot be cancelled by either party.

BC48 In the 2010 exposure draft, the boards proposed to meet the objective of identifying a contract by prescribing when an entity should account for more than one contract as a single contract (ie a contract combination requirement) and when it should account for segments of a single contract as separate contracts (ie a contract segmentation requirement). The boards proposed using a principle of 'price interdependence/independence' for this purpose. Price interdependence is a common principle that underlies the requirements in existing standards (for example, IASs 11 and 18 and ASC Subtopics 605-25 and 605-35) on combining contracts. The boards also proposed using the same principle of price interdependence to determine whether a contract modification should be accounted for as a modification to an existing contract or as a separate contract.

BC49 In their re-deliberations on the 2010 exposure draft, the boards decided to eliminate the step of segmenting a contract into separate (hypothetical) contracts because that step is unnecessary. The boards noted that the proposed requirement to identify the separate

performance obligations in a contract achieves the same result as accounting for the separate components of a contract. Furthermore, although the boards proposed segmenting a contract in order to restrict the allocation of the transaction price (including discounts or subsequent changes in the transaction price), the boards decided to address those matters directly in the proposed requirements on allocation (see paragraphs BC176–BC192).

- BC50 The boards' re-deliberations on the use of the principle of price interdependence in accounting for contract combinations and contract modifications are discussed in the following sections.

Combination of contracts (paragraphs 16 and 17)

- BC51 The 2010 exposure draft included proposed requirements for when an entity should combine two or more contracts and account for them as a single contract. That is because, in some cases, the amount and timing of revenue might differ depending on whether an entity accounts for two or more contracts separately or accounts for them as one contract. The 2010 exposure draft proposed that contracts should be combined if their prices are interdependent and proposed the following indicators that two or more contracts have interdependent prices:

- (a) the contracts are entered into at or near the same time;
- (b) the contracts are negotiated as a package with a single commercial objective; and
- (c) the contracts are performed either concurrently or consecutively.

Those indicators were similar to those in existing standards.

- BC52 Although most respondents agreed that an entity should consider price interdependence for determining whether to combine contracts, some respondents commented that the notion of price interdependence would be too confusing as the overall principle for combining contracts. For instance, it could be difficult to determine whether a discount offered on one contract arises because of price interdependency with another contract or because the discount relates to an existing customer relationship that arises from previous contracts. Making that distinction would be particularly difficult for entities that negotiate each contract *individually* instead of entering into contracts with standard terms. Some respondents were also concerned that the notion of price

interdependence was too broad and could result in an entity being required to combine an initial contract with subsequent contracts between the entity and the customer, including subsequent contracts that arise from the exercise of options in the initial contract.

- BC53 To address those concerns, the boards decided that entering into contracts at or near the same time is a necessary, but not sufficient, condition for the contracts to be combined. That decision is consistent with the contract combination principle of identifying, at contract inception, the contract to be accounted for as the unit of account. In addition to meeting that condition, the boards decided that the contracts would need to satisfy one or more of three criteria. Two of those criteria are based on requirements proposed in the 2010 exposure draft—that the contracts are negotiated as a package with a single commercial objective and that the amount of consideration to be paid in one contract depends on the price or performance of the other contract. The boards observed that when either of those criteria is met, the relationship between the consideration in the contracts is such that if those contracts were not combined, the amount of consideration allocated to the performance obligations in each contract might not faithfully depict the value of the goods or services transferred to the customer. The boards decided to add a further criterion—that the goods or services promised in the contracts would be a single performance obligation in accordance with paragraphs 27–30. The boards added this criterion to avoid the possibility that an entity could effectively bypass the proposed requirements on identifying separate performance obligations depending on how the entity structures its contracts.
- BC54 The boards clarified that for two or more contracts to be combined, they should be with the same customer. However, the boards acknowledged that in some situations, contracts with related parties (as defined in IAS 24 *Related Party Disclosures* and ASC Topic 850 on related party disclosures) need to be combined when there are interdependencies between the separate contracts with those related parties. Thus, in those situations, combining the contracts with related parties would result in a more appropriate depiction of the amount and timing of revenue recognition.

Contract modifications (paragraphs 18–22)

- BC55 A contract modification is a change in the scope or the price of a contract (or both). For contract modifications that amend only the contract price (ie there is no change to the performance obligations), the boards decided that the subsequent change to the transaction price arising from those modifications should be accounted for consistently with changes in the transaction price in accordance with paragraphs 77–80.
- BC56 For all other contract modifications, the boards decided that some modifications change the existing terms and conditions of a contract and other modifications effectively create new or separate contracts. In the 2010 exposure draft, the boards proposed that an entity should distinguish between those modifications by assessing whether the prices of the modification and the existing contract are interdependent. If those prices are interdependent, an entity would account for the modification together with the existing contract and the entity would recognise the cumulative effect of the modification in the period in which the modification occurs (ie the modification would be accounted for on a cumulative catch-up basis). If those prices are not interdependent, the entity would account for the modification as a separate contract (ie the modification would be accounted for prospectively).
- BC57 Respondents generally agreed that contract modifications can have different effects on an entity's rights and obligations and, therefore, the accounting for those modifications should reflect those differences. However, many respondents commented that distinguishing contract modifications on the basis of whether the prices of the modification and the existing contract are interdependent could produce anomalous outcomes. For instance, an entity could be required to account for some contract modifications on a cumulative catch-up basis even though the modification relates only to the remaining performance obligations in the contract. Conversely, an entity could be required to account for other modifications as separate contracts even though the modifications relate to the original contract (for example, change orders in construction industry). Instead of relying only on the principle of price interdependence to distinguish contract modifications, many respondents suggested that factors such as risk or the degree of functionality between the goods or services being provided in the contract(s) should be relevant for determining whether an entity should account for a contract modification as a separate contract or as part of the existing contract. Those factors are consistent with the principles underlying the boards' revised criteria for identifying distinct goods or services.

BC58 The boards agreed with the feedback that the principle of 'price interdependence' was insufficient for determining whether to account for a contract modification as a separate contract or as a modification of an existing contract. Consequently, the boards decided to develop specific criteria for distinguishing contract modifications. In developing those criteria, the boards agreed that, consistently with the core principle of the exposure draft, an entity should account for a modification as a separate contract if the effects of the modification do not affect the amount or timing (ie pattern) of revenue recognition for the existing contract. The boards decided that a contract modification would not change the pattern of revenue recognition for the existing contract if both of the following criteria are met:

- (a) the additional promised goods or services are distinct. That factor indicates that the entity could account separately for the additional goods or services promised in the modification.
- (b) the pricing of the modification reflects the entity's stand-alone selling prices of those additional promised goods or services (subject to any appropriate adjustments to those selling prices to reflect the circumstances of that contract). That factor indicates that the pricing of the modification does not include a material discount or premium that relates to, and therefore should be allocated to, the existing contract. That factor improves on the principle of price interdependence that was proposed in the 2010 exposure draft.

BC59 The boards decided that, in all other cases, contract modifications should be accounted for as amendments to existing contracts. However, accounting for all those contract modifications on a cumulative catch-up basis could be complex and may not necessarily faithfully depict the economics of the modification because the modification is negotiated after the original contract and is based on new facts and circumstances. The boards considered that those concerns typically would arise when an entity's performance completed to date in a contract is separate from its remaining performance obligations (ie the remaining promised goods or services in the modified contract are distinct from the goods or services that have already transferred to the customer). Consequently, the boards decided that an entity should account for the effects of those modifications on a prospective basis. That approach avoids opening up the accounting for previously satisfied performance obligations and, thus, avoids any adjustments to revenue that has already been recognised.

- BC60 If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied (ie a performance obligation satisfied over time), the boards decided that an entity should recognise the effect of the modification on a cumulative catch-up basis by updating the transaction price and the measure of progress for that performance obligation. That approach is particularly relevant and generally accepted in the construction industry because a modification to the contract would not typically result in the transfer of additional goods or services that are distinct from those promised in the existing contract and, accordingly, the modification affects the entity's measure of progress towards completion of the contract.
- BC61 Some respondents to the 2010 exposure draft questioned how the proposed requirements would apply to unpriced change orders (as described in paragraph BC34(d)), which are common in the construction industry. The boards noted that once the parties have approved a change in the scope of the contract, the entity would have a right to payment for work performed. However, because the change order is unpriced, there is uncertainty about the amount of consideration that will be paid. Thus, the boards clarified that in these cases, an entity would apply the proposed requirements for a contract modification when the entity has an expectation that the price of the modification will be approved. The entity would then be able to determine the transaction price in accordance with paragraphs 50–67 and whether the recognition of revenue should be constrained in accordance with paragraphs 81–85.

Identifying performance obligations

Definition of a performance obligation (Appendix A)

- BC62 The proposed requirements distinguish obligations to provide goods or services to a customer from other obligations by describing them as *performance* obligations. The notion of a performance obligation is similar to the notions of deliverables, components or elements of a contract in existing standards. Although the notion of a performance obligation is implicit in many existing standards, the term 'performance obligation' has not been defined previously. Therefore, in the discussion paper, the boards proposed to define a performance obligation as 'a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer' (paragraph 3.2).

- BC63 The 2010 exposure draft proposed a similar definition of a performance obligation. However, the proposed definition in the 2010 exposure draft specified that the promise must be enforceable. Respondents to the 2010 exposure draft expressed concerns about the term ‘enforceable’ because they thought that an entity should account for some promised goods or services as performance obligations even though the promise to transfer those goods or services may not be enforceable (for example, some when-and-if-available software upgrades and award credits associated with customer loyalty programmes). Consequently, the boards decided that although a contract with a customer must be enforceable, a performance obligation could arise from a promise associated with a contract if the customer has a valid expectation that the entity will transfer a good or service. In making that decision, the boards noted that identifying a performance obligation based on such promises is consistent with both of the following:
- (a) the core principle of the exposure draft, because an entity would account for promised goods or services that the customer reasonably expects to receive and for which the customer promises to pay; and
 - (b) the current application of IFRSs and US GAAP (for example, the definition of a constructive obligation in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*).

Marketing incentives, incidental obligations and perfunctory obligations

- BC64 Some respondents to the 2010 exposure draft suggested that an entity should account for some promised goods or services as marketing expenses or as incidental obligations even though those promises meet the definition of a performance obligation. Examples of such promised goods or services include ‘free’ handsets provided by telecommunication entities and customer loyalty points awarded by supermarkets, airlines and hotels. Those respondents thought that revenue should be recognised only for the main goods or services for which the customer has contracted and not for the marketing incentives and other incidental obligations.
- BC65 When a customer contracts with an entity for a bundle of goods or services, it can be difficult and subjective for the entity to identify the ‘main’ goods or services for which the customer has contracted. In addition, the outcome of that assessment could vary significantly depending on whether an entity performs the assessment from the

perspective of its business model or from the perspective of the customer. Consequently, the boards decided that all goods or services promised to a customer as a result of a contract are performance obligations because they are part of the negotiated exchange between the entity and its customer. Although the entity might consider 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 purposes of revenue recognition. In contrast to performance obligations in a contract, marketing incentives are provided independently of the contract that the incentives are designed to secure. (See paragraphs BC296–BC304 for additional discussion on marketing incentives and the accounting for customer options to acquire additional goods or services.)

- BC66 For similar reasons, the boards decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity would assess whether those performance obligations are immaterial in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and ASC Topic 105 on generally accepted accounting principles.

Identifying separate performance obligations (paragraphs 23–30)

- BC67 Contracts with customers can contain many performance obligations. In the discussion paper, the boards proposed that an entity should refer to the timing of the transfer of the promised goods or services to identify the performance obligations that it should account for separately. Respondents to the discussion paper were concerned that this proposal would require an entity to account separately for every promised good or service in a contract that is transferred at a different time, which would not be practical for many contracts, especially for long-term services and construction contracts. Consequently, in developing both the 2010 exposure draft and this exposure draft, the boards' intention was to develop clear requirements that would result in an entity identifying separate performance obligations in a way that would be both practical and result in a pattern of revenue recognition that faithfully depicts the transfer of goods or services to the customer.
- BC68 During outreach activities on the discussion paper and on the 2010 exposure draft, the boards observed that, for many contracts, it is intuitive for an entity to identify the promised goods or services that the entity should account for separately. Consequently, the boards wanted to develop a principle for identifying separate performance obligations that

would be intuitive when applied across the various industries and transactions in the scope of the proposed requirements. That principle is the notion of a good or service that is distinct. The term distinct, in an ordinary sense, suggests something that is different, separate or dissimilar. However, to avoid the significant diversity in practice that could result from the proposed requirements relying too heavily on the judgement of an entity about whether a good or service is distinct, the boards decided to specify when a good or service is distinct.

BC69 In the 2010 exposure draft, the boards proposed that a good or service is distinct if it is sold separately (by the entity or by another entity) or if it could be sold separately. The boards were concerned that requiring an entity to account separately (and estimate a stand-alone selling price) for a good or service that is not capable of being sold separately might result in information that would not be useful to users of financial statements. The boards specified in the 2010 exposure draft that a good or service must have both of the following attributes to be capable of being sold separately:

- (a) a distinct function (ie the good or service must have utility either on its own or together with other goods or services that the customer has acquired from the entity or that are sold separately by the entity or another entity); and
- (b) a distinct profit margin (ie the good or service must be subject to distinct risks and the entity must be able to separately identify the resources needed to provide the good or service).

BC70 A majority of respondents to the 2010 exposure draft agreed with using the principle of 'distinct' to identify the separate performance obligations in a contract. However, many respondents were still concerned that applying the criteria for determining when a good or service is distinct would not be practical and would result in an entity unbundling a contract into components that are identified without considering the economics of the transaction. Those concerns related mainly to the proposal that a good or service is distinct if it is sold separately by the entity or by another entity. Some respondents commented that the experience of other entities, including entities that operate in other markets or other jurisdictions, could be costly to obtain and would not be relevant for determining whether an entity should account separately for a promised good or service. In addition, respondents were concerned that many construction- and production-type contracts would be accounted for as many separate performance obligations because each component of the contract is sold separately (for

example, by a subcontractor or by a supplier of building materials). Respondents thought that not only would it be impractical for an entity to account for those types of contracts as consisting of many performance obligations, but doing so would not reflect the economics of those transactions because the promised goods or services are highly interrelated and interdependent (ie each good or service in the bundle is not distinct).

BC71 Respondents to the 2010 exposure draft also raised some concerns about the use of distinct function and distinct profit margin as attributes of a distinct good or service. Respondents requested additional guidance on the meaning of distinct function because they considered that almost any element of a contract could have utility in combination with other goods or services. Respondents also found the distinct profit margin criterion to be confusing for the following reasons:

- (a) entities may decide to assign the same margin to various goods or services even though those goods or services use different resources and are subject to different risks; and
- (b) for some goods or services, especially for software and other types of intellectual property, cost is not a significant factor in determining price and, therefore, margins could be highly variable because they may be determined by the customer's ability to pay or to obtain substitute goods or services from another entity.

BC72 In the exposure draft, the boards affirmed their 2010 proposal that an entity should identify the separate performance obligations in a contract on the basis of whether a promised good or service is distinct. However, in response to the feedback on the 2010 exposure draft, the boards refined the criteria for determining when a good or service is distinct by specifying:

- (a) the attributes that all goods or services must possess to be capable of being distinct (see paragraph 28); and
- (b) the attributes of goods or services that when promised together (ie as a bundle) are not distinct, even if the individual goods or services otherwise would meet the criteria in paragraph 28 (see paragraph 29).

Attributes of a distinct good or service (paragraph 28)

- BC73 The boards propose two criteria that would provide evidence that a good or service is capable of being distinct. One criterion (in paragraph 28(b)) specifies that 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’. That criterion expands on the notion of a distinct function in the 2010 exposure draft by clarifying that a good or service is distinct if either of the following conditions is met:
- (a) the customer can benefit from the good or service on its own (ie the good or service is an asset that, on its own, can be used, consumed, sold for an amount other than a scrap value, held, or otherwise used in a way that generates economic benefits); or
 - (b) the customer can benefit from the good or service when the good or service is combined with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer has already obtained (from the entity or from other transactions or events).
- BC74 The other criterion (in paragraph 28(a)) that ‘the entity regularly sells the good or service separately’ is a practical expedient for determining whether a good or service would meet the criterion in paragraph 28(b). That is because, in concept, any good or service that is sold separately should be able to be used on its own or with other resources, otherwise there would be no market for an entity to provide that good or service on a stand-alone basis. The boards decided to limit the scope of the practical expedient to only the entity’s stand-alone sales because of concerns raised previously by respondents that the experience of other entities was not relevant for determining whether a good or service is distinct.
- BC75 If a good or service is not distinct in accordance with the criteria in paragraph 28, it is questionable whether it is an asset. Hence, the boards thought that requiring a good or service to be distinct would emphasise that an entity can have a performance obligation only for promises that, when fulfilled, would result in the transfer of an asset to the customer.
- BC76 The proposed attributes of a distinct good or service are comparable to the requirements on multiple-element arrangements in ASC Subtopic 605-25, which specifies that a delivered item have ‘value to the customer on a stand-alone basis’ for an entity to account for that item separately. However, the boards decided against using that terminology because it could suggest that an entity must identify performance obligations on

the basis of an assessment of the customer's intended use of the promised goods or services, which would affect the 'value to the customer'. It would be difficult, if not impossible, for an entity to know the customer's intentions in any given contract. In addition, the boards noted that an item that has value to the customer on a stand-alone basis is defined as an item that the customer could resell (even in a hypothetical market). Therefore, the boards decided not to carry forward the terminology in ASC Subtopic 605-25 as an additional criterion for determining whether a good is distinct for the following reasons:

- (a) nearly any item could be resold by the customer (although possibly only for scrap value);
- (b) in some circumstances, an item may be distinct but the customer may not have the ability to resell that item because of contractual restrictions (for example, to protect the entity's intellectual property); and
- (c) the ability to resell an item is included in the criterion in paragraph 28(b), which considers a distinct good or service from the perspective of whether the customer benefits from the good or service on its own or together with other goods or services that are readily available to the customer.

Bundles of goods or services (paragraph 29)

- BC77 The boards decided that the criteria for a distinct good or service in paragraph 28 are necessary to identify separate performance obligations but they are not sufficient. In other words, an entity must consider the attributes of an individual good or service but the entity also must consider how that good or service is bundled with other goods or services in a particular contract.
- BC78 During the re-deliberations following the 2010 exposure draft, the boards observed that, in some cases, the individual goods or services in a bundle might meet the criteria in paragraph 28, but those goods or services would not be distinct because of the way in which the goods or services are bundled. In those cases, the risk that an entity assumes to fulfil its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risks relating to the transfer to the customer of the other promised goods or services in that bundle. Hence, the boards considered whether to specify 'separable risks' as an additional attribute of a distinct good or service. Although the boards considered that the existence of separable risks indicated that a good or service is distinct, the boards decided that, given the feedback on the 2010

exposure draft, the concept of inseparable risks may not be an intuitive or practical criterion for determining whether a good or service is distinct. That is because it may be difficult for an entity to determine which risks should be included in that assessment. Instead, the boards decided to develop the following criteria to clearly identify the circumstances in which an entity promises goods or services as a bundle and the goods or services are not individually distinct because the risks of providing the bundle of goods or services are largely inseparable:

- (a) ‘the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted’ (see paragraph 29(a)); and
- (b) ‘the bundle of goods or services is significantly modified or customised to fulfil the contract’ (see paragraph 29(b)).

BC79 Those criteria typically are met when an entity uses goods or services as inputs into a single process or project that is the output of the contract. A single process or project can comprise more than one phase, element or unit of output. The boards developed the criterion specified in paragraph 29(a) using feedback on the 2010 exposure draft and suggestions from respondents (especially respondents from the construction and manufacturing industries) that the standard should include some of the discussion in the 2010 exposure draft’s Basis for Conclusions on distinct profit margins. That discussion highlighted that, in many construction contracts, the contractor provides an integration service in addition to providing or subcontracting for goods or services to complete individual construction tasks. That integration service provided by the contractor is to manage and co-ordinate the various construction tasks. Moreover, if a contractor employs subcontractors, that service might also cover the risk that the tasks performed by the subcontractors are not in accordance with the contract specifications and do not combine with other services to provide the integrated construction services for which the customer contracted. The boards added the criterion in paragraph 29(b) because without it there was a risk that all contracts that include any type of integration service might be deemed to be a single performance obligation even if the risk that the entity assumes in integrating the promised goods or services is negligible (for example, a simple installation of standard equipment).

BC80 Although the criteria in paragraph 29 were developed in response to feedback that was received largely from the construction industry, the criteria are intended to apply to other industries and transactions with similar features. For example, some software development contracts will similarly have promised products and services that meet the criteria in paragraph 29 and, hence, would be accounted for as a single performance obligation.

Pattern of transfer (paragraph 30)

BC81 In the 2010 exposure draft, the boards proposed that an entity need not account separately for goods or services if accounting for those goods or services together would result in the same pattern of revenue recognition. Those requirements would apply if those goods or services are transferred to the customer at the same point in time or if they are transferred to the customer over the same period of time and the same method of measuring progress is used to depict the transfer of goods or services to the customer. The boards decided to carry forward those requirements in this exposure draft as a practical expedient when identifying the separate performance obligations in a contract with a customer. The practical expedient is intended to address the concerns raised by some respondents that they frequently would have to identify numerous performance obligations and account for them separately. The boards noted that, in at least some of the examples raised by respondents, an entity would not need to account for those performance obligations separately because the pattern of transfer would be the same. For example, if an entity promises to provide professional services for one year, each increment of service may meet the criteria for being distinct. However, it is likely that an entity would account for the services as a single performance obligation if the entity could select a single method of measuring progress that appropriately depicts its performance throughout the year.

Satisfaction of performance obligations (paragraphs 31–47)

BC82 In the proposed requirements, revenue would be recognised when (or as) goods or services are transferred to a customer. That is because an entity satisfies its performance obligation (ie fulfils its promise to the customer) by transferring the promised good or service underlying that performance obligation to the customer. Therefore, assessing when a good or service is transferred is a critical step in applying the proposed requirements.

Control

- BC83 Most existing revenue standards require an entity to assess the transfer of a good or service by considering the transfer of risks and rewards of ownership. However, the boards decided that an entity should assess the transfer of a good or service by considering when the customer obtains control of that good or service for the following reasons:
- (a) both goods and services are assets that a customer acquires (even if many services are not recognised as an asset by the customer because those services are simultaneously received and consumed by the customer) and the boards' existing definitions of an asset use control to determine when an asset is recognised or derecognised;
 - (b) assessing the transfer of goods or services using control should result in more consistent decisions about when goods or services are transferred because it can be difficult for an entity to judge whether a preponderance (or some other balance) of the risks and rewards of ownership of a good or service has been transferred to the customer if the entity retains some risks and rewards; and
 - (c) a risks and rewards approach could conflict with identifying separate performance obligations. For example, if an entity transfers a product to a customer but retains some risks associated with that product, an assessment based on risks and rewards might result in the entity identifying a single performance obligation that could be satisfied only after the risks are eliminated. However, an assessment based on control might appropriately identify two performance obligations—one for the product and another for a remaining service such as a fixed price maintenance agreement. Those performance obligations would be satisfied at different times.
- BC84 Many respondents to the 2010 exposure draft agreed with using control to determine when a good or service is transferred to a customer. However, they indicated that the transfer of risks and rewards of ownership is sometimes a helpful indicator that control has transferred (see paragraph BC107).

Developing the notion of control

BC85 The boards developed a description of control for the proposed requirements based on the meaning of control in the definitions of an asset in the boards' respective conceptual frameworks. Thus, the boards determined that control of a promised good or service (ie an asset) is the customer's ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Those components are explained as follows:

- (a) ability—a customer must have the *present* right to direct the use of and obtain substantially all the remaining benefits from an asset for an entity to recognise revenue. For example, in a contract that requires a manufacturer to produce an asset for a particular customer, it might be clear that the customer ultimately will have the right to direct the use of and obtain substantially all the remaining benefits from the asset. However, the entity should not recognise revenue until the customer has obtained that right (which, depending on the contract, might occur during production or afterwards).
- (b) direct the use of—a customer's ability to direct the use of an asset refers to the customer's right to deploy that asset in its activities, to allow another entity to deploy that asset in its activities or to restrict another entity from deploying that asset.
- (c) obtain the benefits from—the customer must have the ability to obtain substantially all the remaining benefits from an asset for the customer to obtain control of it. In concept, the benefits from a good or service are potential cash flows (either an increase in cash inflows or a decrease in cash outflows). An entity can obtain the benefits directly or indirectly in many ways, such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.

BC86 The boards observed that the assessment of when control has transferred could be applied from the perspective of either the entity selling the good or service or the customer purchasing the good or service. Consequently, revenue could be recognised when the seller surrenders control of a good or service or when the customer obtains control of that good or service. Although in many cases both perspectives lead to the same result, the boards decided that control should be assessed primarily from the perspective of the customer. That perspective would minimise the risk of an entity recognising revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer.

Applying the notion of control

- BC87 As discussed above, many respondents to the 2010 exposure draft agreed with using control as the basis for assessing when the transfer of a promised good or service (ie an asset) occurs. Respondents also acknowledged the progress made by the boards since the discussion paper in developing guidance for applying control to contracts with customers. However, respondents stated that the additional guidance for assessing the transfer of control proposed in the 2010 exposure draft was most helpful when applied to performance obligations for the transfer of goods. They commented that applying the concept of control is intuitive in those cases because, typically, it is clear that an asset has transferred from the entity to its customer. But they noted that the guidance was less intuitive and more difficult to apply to performance obligations for services and construction-type contracts because it could be difficult to determine when a customer obtains control of a service. That is because in many service contracts the service asset is simultaneously created and consumed and, therefore, it is never recognised as an asset by the customer. And even in the case of a construction contract in which there is a recognisable asset, it can be difficult to assess whether a customer has the ability to direct the use of and obtain substantially all the remaining benefits from a partially completed asset that the seller is in the process of creating. Consequently, many respondents in the construction industry were concerned that they would be required to change their revenue recognition policy from using a percentage of completion method to a completed contract method (on the basis that the transfer of assets occurs only upon transfer of legal title or physical possession of the finished asset, which typically occurs upon contract completion).
- BC88 As a result, some respondents suggested that the boards provide requirements for the transfer of control of services separately from the requirements for goods. The boards decided that the notion of control should apply equally to goods and services. However, to address respondents' concerns, the boards decided to specify requirements that would focus on the attribute of the timing of when a performance obligation is satisfied (ie when a good or service is transferred to a customer). That is because it would be difficult to clearly define a service and not all contracts that are commonly regarded as services result in a transfer of resources to customers over time. Accordingly, the proposed requirements include criteria for determining whether a performance obligation is satisfied over time.

Performance obligations satisfied over time (paragraphs 35 and 36)

BC89 The boards developed the additional requirements in paragraph 35 of this exposure draft to assist an entity in determining when goods or services are transferred over time and, thus, when a performance obligation is satisfied over time. Those proposed requirements are divided into two categories—one for when the entity’s performance creates or enhances an asset of the customer and another for when the entity’s performance does not create an asset with alternative use to the entity.

Performance creates or enhances an asset that the customer controls as it is created (paragraph 35(a))

BC90 The boards decided that if an entity’s performance creates or enhances an asset that the customer controls as the asset is created or enhanced, the entity’s performance transfers goods or services to the customer. Accordingly, in such cases a performance obligation is satisfied over time as the entity creates or enhances that asset. For example, the performance obligation is satisfied over time in many construction contracts when the customer controls any work-in-progress (tangible or intangible) arising from the entity’s performance.

BC91 This criterion is consistent with the proposed application guidance in the 2010 exposure draft on determining whether a good or service is transferred over time. That guidance stated that goods or services would be transferred over time if the customer controls the work-in-progress as it is created. Many respondents to the 2010 exposure draft agreed with that concept but thought it needed to be articulated more prominently in the standard itself. In the boards’ view, the concept of control is similar to the basis for percentage of completion accounting in accordance with paragraph 22 of AICPA Statement of Position 81-1 *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*:

Under most contracts for construction of facilities, production of goods, or provision of related services to a buyer’s specifications, both the buyer and the seller (contractor) obtain enforceable rights. The legal right of the buyer to require specific performance of the contract means that the contractor has, in effect, agreed to sell his rights to work-in-progress as the work progresses. This view is consistent with the contractor’s legal rights; he typically has no ownership claim to the work-in-progress but has lien rights. Furthermore, the contractor has the right to require the buyer, under most financing arrangements, to make progress payments to support his ownership investment and to approve the facilities constructed (or goods produced or services performed) to date if they meet the contract requirements. The buyer’s right to take over the work-in-progress at his

option (usually with a penalty) provides additional evidence to support that view. Accordingly, the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses.

Performance does not create an asset with an alternative use to the entity (paragraph 35(b))

- BC92 This second criterion was developed for performance obligations for which it may not be clear whether any asset that is created or enhanced is controlled by the customer, or for which the entity's performance does not result in a recognisable asset.
- BC93 In developing this criterion, the boards decided that it would be easier to determine when the entity's performance results in a transfer of goods or services to the customer by first eliminating the circumstances in which the entity's performance would *not* result in a transfer of goods or services to the customer. The boards decided that an entity's performance would not result in a transfer of goods or services to the customer if the entity's performance creates an asset with an alternative use to the entity. If an asset has an alternative use to an entity, the entity could readily direct the asset to another customer. For instance, in many cases an asset will have an alternative use because it is a standard inventory-type item and the entity has discretion to substitute the item across contracts with customers. Because the entity has discretion to substitute the asset being created for a similar item, the customer cannot control the asset.
- BC94 Conversely, if an entity creates an asset that is highly customised for a particular customer, then the asset would be less likely to have an alternative use because the entity likely would incur significant costs to reconfigure the asset for sale to another customer (or would need to sell the asset for a significantly reduced price). The boards observed that the level of customisation might be a helpful factor to consider when evaluating whether an asset has an alternative use. However, the boards decided that it should not be a determinative factor because, in some cases (for example, some real estate, software or some manufacturing contracts), an asset might be standardised but yet still might not have an alternative use to an entity as a result of contractual or practical limitations that preclude the entity from readily directing the asset to another customer. If a contract precludes the entity from transferring an asset to another customer, the entity does not have an alternative use for that asset because it is legally obliged to direct the asset to the customer.

BC95 Having decided that a performance obligation can be satisfied over time only if the entity's performance does not create an asset with alternative use to the entity, the boards then developed the three additional criteria in paragraph 35(b). The boards decided that those criteria were necessary to determine that control of the good or service transfers to the customer over time as the entity performs and, hence, the performance obligation is satisfied over time.

The customer simultaneously receives and consumes benefits as the entity performs (paragraph 35(b)(i))

BC96 In some cases in which an entity's performance does not create an asset with an alternative use to the entity, the customer simultaneously receives a benefit and consumes that benefit as the entity performs. In those cases, the entity is transferring goods or services as it performs, thereby satisfying its performance obligation over time. For example, consider an entity that promises to process transactions on behalf of a customer. The entity's processing of each transaction does not create an asset with an alternative use to the entity and the customer simultaneously receives and consumes a benefit as each transaction is processed. Consequently, the entity would satisfy its performance obligation over time as those transactions are processed for the customer.

Another entity would not need to substantially re-perform the work completed to date (paragraph 35(b)(ii))

BC97 In other cases in which the entity's performance does not create an asset with an alternative use to the entity, it is less clear that the customer benefits from the entity's performance as it occurs. To address this issue, the second criterion would require an entity to consider whether another entity would need to substantially re-perform the work completed to date to fulfil the remaining obligation. That is because a customer must have benefited from the entity's performance completed to date (ie received goods or services) if another entity could simply fulfil the remaining obligation to the customer without substantially re-performing the work completed to date. For example, consider a freight logistics company that has an obligation to transport a customer's asset by road from Vancouver to New York. If the company transports the asset halfway to its destination (or perhaps to a hub that may be further away from the asset's destination), another company could fulfil the remaining obligation to the customer without having to re-perform the transportation service provided to date.

- BC98 The boards decided that when determining whether another entity would need to re-perform any work, it is important to disregard the benefit of any assets related to the contract (for example, work-in-progress) that are controlled by the entity. For instance, in a construction contract, another entity would not be able to fulfil the remaining obligation without re-performing work completed to date if the entity controls the work-in-progress. It would be able to do so only if the customer controls the work-in-progress.
- BC99 In practice, there may be contractual or other constraints on an entity's ability to transfer a (partially satisfied) performance obligation to another entity. However, the boards decided that the application of this criterion should not be constrained by contractual or practical limitations of transferring the performance obligation because the objective is to determine whether goods or services are transferred to the customer as the entity performs.

The entity has a right to payment for performance completed to date (paragraph 35(b)(iii))

- BC100 For some performance obligations for which performance does not create an asset with an alternative use to the entity, the criteria of a 'customer simultaneously receives and consumes the benefits' and 'another entity would not need to substantially re-perform' will not help the entity in determining whether its performance transfers goods or services over time. To address these circumstances, the boards decided that the entity should consider whether it has a right to payment for performance completed to date. The boards decided that if an entity's performance completed to date does not create an asset with an alternative use to the entity (for example, an asset that could readily be directed to another customer) and the customer is obliged to pay for that performance to date, then the customer could be regarded as receiving the benefit from that performance.
- BC101 In using the term 'right to payment', the boards mean a payment that is intended to compensate an entity for its performance completed to date rather than, for example, payment for a deposit or to compensate the entity for inconvenience or loss of profit. Accordingly, an entity would not have a right to payment for its performance completed to date if the entity could recover only compensation from the customer for a loss of profit that would occur as a result of the customer terminating the contract and the entity incurring significant rework costs to be able to redirect the asset to another customer. In addition, the boards do not mean that the entity must have a present unconditional right to

payment. In many cases, an entity will have that right only at an agreed-upon milestone or on complete satisfaction of the performance obligation. Therefore, in assessing whether it has that right, the entity should consider whether it is entitled to payment for performance completed to date, assuming that it will fulfil the remaining performance obligation(s) (unless it does not expect to fulfil the contract as promised, in which case the entity may not be entitled to payment for performance completed to date).

BC102 For example, consider a consulting contract in which the consulting entity agrees to provide a report at the end of the contract for an amount that is conditional on successfully providing that report. If the entity is performing under that contract, it would have a right to payment if the terms of the contract (or the contract law in the entity's jurisdiction) require the customer to compensate the entity for its work completed to date if the customer terminated the contract.

BC103 In the proposed requirements for determining when a performance obligation is satisfied over time, the boards decided that the criterion of whether an entity has a right to payment for performance completed to date was necessary only in cases in which the entity's performance does not create an asset with an alternative use to the entity and neither of the criteria in paragraphs 35(b)(i) or (ii) is met. The boards considered whether they should specify a right to payment for performance completed to date as a more overarching criterion in determining when a performance obligation is satisfied. However, they decided against this for the following reasons:

- (a) an entity must have a contract to recognise revenue in accordance with the proposed requirements and a component of a contract is a right to payment.
- (b) the core revenue recognition principle is about determining whether goods or services have been transferred to a customer, not whether the entity has a right to payment. Including a right to payment as an overarching criterion could potentially obscure that revenue recognition principle.
- (c) a right to payment does not necessarily determine a transfer of goods or services (for example, in some contracts, customers are required to make non-refundable upfront payments and do not receive any goods or services in exchange).
- (d) in cases in which the customer clearly receives benefits as the entity performs, as in many service contracts, the possibility that

the entity will not ultimately retain the payment for its performance is dealt with in measuring revenue. For example, in some service contracts that would meet the combination of the criteria in paragraph 35(b) and paragraphs 35(b)(i) or (ii), the customer may be able to terminate the contract and receive a full refund of its consideration. In such cases, the boards decided that because the entity is transferring services to the customer, it should recognise revenue subject to being reasonably assured of being entitled to the consideration.

Performance obligations satisfied at a point in time (paragraph 37)

- BC104 The boards decided that all performance obligations that do not meet the criteria for being satisfied over time should be accounted for as performance obligations satisfied at a point in time. For performance obligations satisfied at a point in time, an entity should apply the indicators of control to determine the point in time when the performance obligation is satisfied.
- BC105 The 2010 exposure draft included indicators to assist an entity in determining when the customer obtains control of a good or service. Because many respondents commented that those proposed requirements were useful for contracts for the sales of goods, the boards decided to carry forward those indicators to assist an entity in determining when it has transferred control of an asset (whether tangible or intangible), with some amendments for clarification.
- BC106 Some respondents to the 2010 exposure draft questioned whether all of the indicators would need to be present for an entity to conclude that it had transferred control of a good or service or what an entity should do if some but not all of the indicators were present. In their re-deliberations, the boards emphasised that the proposed guidance in paragraph 37 is not a checklist. Rather, it is a list of factors that are often present when a customer has control of an asset, and is provided to assist entities in applying the principle of control in paragraph 31.
- BC107 In the proposed requirements, the boards added the indicator ‘the customer has the significant risks and rewards of ownership of the asset’ in the light of comments from respondents who disagreed with the boards’ proposal to eliminate considerations of the ‘risks and rewards of ownership’ from the recognition of revenue. Respondents observed that ‘risks and rewards’ can be a helpful factor to consider when determining the transfer of control, as highlighted by the IASB in IFRS 10 *Consolidated*

Financial Statements, and is often a consequence of controlling an asset. The boards decided that adding risks and rewards as an indicator would provide additional guidance but would not change the principle of determining the transfer of goods or services on the basis of the transfer of control.

- BC108 The boards also added the indicator ‘the customer has accepted the asset’. The 2010 exposure draft included that notion as application guidance; however, the boards decided to relocate that guidance to the indicators of control in this exposure draft.
- BC109 Many respondents to the 2010 exposure draft were concerned about the application of the indicator that the ‘design or function of the good or service is customer-specific’ (which was proposed in paragraph 30(d) of the 2010 exposure draft). For many, it was not clear how the indicator related to the objective of determining the transfer of control because the customer might clearly control an asset even though the design or function of that asset is not customer-specific. Conversely, a customer might not control an asset with a customer-specific design or function. The boards noted that because the indicator had been developed mainly for service contracts, that indicator would not be necessary if separate requirements were developed for determining when performance obligations are satisfied over time. Thus, the boards decided to eliminate this as an indicator of control. As described in paragraph BC94, the notion of customer-specific design or function has been developed into the criterion of ‘an asset with no alternative use to the entity’.
- BC110 Respondents to the 2010 exposure draft also suggested additional conditions such as the entity’s lack of continuing involvement (for example, a call option on a delivered good). The boards have included application guidance to help an entity assess the transfer of control in those circumstances.

IFRIC 15 Agreements for the Construction of Real Estate

- BC111 In developing the proposed requirements for assessing when goods or services transfer to the customer, the boards considered the diversity in practice from applying *IFRIC 15 Agreements for the Construction of Real Estate*. That diversity in practice results from the difficulty in determining when control of a good transfers to the customer over time by applying the recognition criteria in paragraph 14 of IAS 18 to complex contracts with

different facts and circumstances. The boards observe that this diversity in practice is consistent with the feedback received on the proposals in the 2010 exposure draft on determining when control of a good or service transfers over time.

- BC112 The boards envisage that the diversity in practice should be reduced by the proposed requirements in paragraphs 35 and 36 that clarify when goods or services transfer over time. However, the boards observe that the pattern of transfer may be different for different contracts because the pattern of transfer will depend on the relevant facts and circumstances of each contract. For example, some real estate contracts may result in an asset that cannot (under the terms of the contract) be readily directed to another customer (ie the entity's performance does not create an asset with an alternative use to the entity), and the contract requires the customer to pay for performance to date (thus meeting the criteria in paragraphs 35(b) and (b)(iii)). However, many of those real estate contracts that do not create an asset with an alternative use to the entity may not require the customer to pay for performance to date. Thus, for those contracts, an entity may reach a different conclusion on the pattern of transfer.

Measuring progress (paragraphs 38–48)

- BC113 When an entity determines that a separate performance obligation is satisfied over time, the entity must determine how much revenue to recognise in each reporting period by measuring its progress towards complete satisfaction of the performance obligation.
- BC114 There are various methods that an entity might use to measure its progress towards complete satisfaction of a performance obligation. Because of the breadth of the scope of the proposed requirements, the boards decided that it would not be feasible to consider all possible methods and prescribe when an entity should use each method. Accordingly, an entity should use judgement when selecting an appropriate method of measuring progress. That does not mean that an entity has a 'free choice'. The proposed requirements state that an entity should select a method of measuring progress that is consistent with the clearly stated objective of depicting the transfer of goods or services to the customer (ie the entity's performance).
- BC115 Furthermore, an entity should apply the selected method consistently for that performance obligation and also across contracts that have performance obligations with similar characteristics. The boards decided that an entity should not use different methods to measure its

performance in satisfying the same or similar performance obligations because that could reduce comparability. Moreover, an entity would effectively bypass the proposed requirements for identifying separate performance obligations and allocating the transaction price to those performance obligations on the basis of stand-alone selling prices if the entity were to use more than one method to measure its performance in fulfilling a performance obligation. That is because the entity would need to identify subcomponents of a performance obligation to which the different measures of performance relate and to allocate a portion of the transaction price to those subcomponents on a basis other than stand-alone selling prices. A different basis of allocation would be required because, by virtue of those subcomponents not being distinct goods or services, those subcomponents would not be capable of being sold as stand-alone goods or services.

- BC116 The proposals in paragraphs 38–48 carry forward some of the proposals in the 2010 exposure draft. However, in the light of feedback received, the boards have clarified and expanded those proposed requirements as explained below.

Output methods (paragraphs 41–43)

- BC117 Consistently with existing requirements, the boards explained in the 2010 exposure draft that output methods often result in the most faithful depiction of the transfer of goods or services to a customer. Some respondents agreed with that proposal in concept but thought that the 2010 exposure draft did not sufficiently describe the advantages and disadvantages of output and input methods. In addition, some thought that the 2010 exposure draft was too biased towards output methods and asked the boards to remove the stated preference for output methods.
- BC118 In re-deliberating the proposals, the boards affirmed 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. The boards noted that the description of output methods in the 2010 exposure draft implied that recognising revenue using 'units of delivery' and 'contract milestone' methods would always be superior methods of recognising revenue for performance obligations satisfied over time compared with input methods. However, the boards observe that such methods may not always result in appropriate depictions of the entity's performance over time. For example, a 'units of delivery' method may be an appropriate method for a long-term manufacturing contract of standard items that individually transfer an equal amount of value to the customer.

However, a ‘units of delivery’ method may not be appropriate if the contract provides both design and production services because in this case each item produced may not transfer an equal amount of value to the customer. Accordingly, in the proposed requirements, the boards have clarified the description of an output measure and explained that ‘units of delivery’ and ‘contract milestones’ are examples of output measures.

- BC119 The boards have also clarified that, in some circumstances, another output method would be to recognise revenue at the amount of consideration to which the entity has a right to invoice. This method would be appropriate if the amount of consideration that the entity has a right to invoice corresponds directly with the value of each incremental good or service that the entity transfers to the customer (ie the entity’s performance to date). This may occur, for example, in a services contract in which an entity invoices a fixed amount for each hour of service provided.
- BC120 The boards also acknowledged that, in some circumstances, an output method can be unnecessarily costly for an entity to apply. Therefore, in those situations, it would be appropriate for an entity to select an input method to measure its progress provided that an input method is a reliable proxy of the outputs to the customer.

Input methods (paragraphs 44–46)

- BC121 In some contracts, an entity promises to transfer both goods and services to the customer and the customer takes control of the goods, which are a significant part of the performance obligation, at a different time from the services (for example, the customer obtains control of the goods before they are installed). If those goods and services are not distinct, then the entity would have a single performance obligation. Because there is diversity in practice about how to apply an input method to measure progress in such situations, the boards decided to provide additional guidance.
- BC122 The boards observed that if the customer obtains control of the goods, then it would be inappropriate for the entity to continue to recognise the goods as inventory. Instead, the entity should recognise revenue for the transferred goods in accordance with the core principle of the proposed requirements. The boards also observed that if the entity applies a cost-to-cost method of measuring progress, the entity might (in the absence of clear requirements in the exposure draft) include the cost of the goods in the cost-to-cost calculation and, hence, recognise a

contract-wide profit margin for the transfer of the goods. The boards thought that recognising a contract-wide profit margin before the goods are installed could overstate the measure of the entity's performance. Alternatively, requiring an entity to estimate a margin that is different from the contract-wide margin could be complex and could effectively create a separate performance obligation for goods that are not distinct (thus bypassing the proposed requirements for identifying separate performance obligations). Hence, the boards decided that, in specified circumstances, an entity should recognise revenue for the transfer of the goods but only in an amount equal to the cost of those goods. In those circumstances, an entity would exclude the costs of the goods in the cost-to-cost calculation and recognise the margin on the transferred goods as the entity satisfies its single separate performance obligation.

Reasonable measures of progress (paragraphs 47 and 48)

BC123 The boards clarified that when selecting a method to measure progress and, thus, determining when to recognise revenue, an entity should recognise revenue for its performance only if it can reasonably measure its progress towards complete satisfaction of the performance obligation. However, in cases in which an entity cannot reasonably measure its progress but the entity expects to recover the costs incurred in satisfying the performance obligation, the boards thought that the entity should recognise at least some amount of revenue to reflect the fact that it is making progress in satisfying the performance obligation. Therefore, in these cases, the boards decided that an entity should recognise revenue for the satisfaction of the performance obligation only to the extent of the costs incurred. (That method is consistent with existing requirements for measuring progress in IASs 11 and 18 and ASC Subtopic 605-35.) However, the boards also decided that an entity would stop using that method when it can reasonably measure its progress towards complete satisfaction of the performance obligation or when the performance obligation becomes onerous.

Measurement of revenue (paragraphs 49–67)

BC124 In their re-deliberations, the boards affirmed the proposal in the 2010 exposure draft to measure revenue based on an allocated transaction price approach. Under that approach, an entity would allocate the transaction price to each separate performance obligation at an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance

obligation. That allocation would determine the amount of revenue that an entity recognises when (or as) it satisfies each performance obligation. Most respondents to the discussion paper and the 2010 exposure draft supported the allocated transaction price approach.

- BC125 The boards considered, but rejected, an alternative measurement approach, which would have been to measure the remaining performance obligations directly at each reporting date. The boards observed that this alternative would make accounting for the contract more complex. In addition, the boards expected that it would provide little additional information to users of financial statements in many cases, either because the values of goods or services promised are not inherently volatile or because the effect of any volatility that might exist is limited because an entity transfers the goods or services to the customer over a relatively short time. Paragraphs BC26–BC28 include additional discussion on rejected measurement approaches.
- BC126 The allocated transaction price approach would generally require an entity to follow three main steps to determine the amount of revenue that can be recognised for satisfied performance obligations. Those steps are as follows:
- (a) determine the transaction price for the contract;
 - (b) allocate the transaction price to separate performance obligations; and
 - (c) recognise revenue at the amount allocated to the satisfied performance obligation. When the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue recognised should not exceed the amount to which the entity is reasonably assured to be entitled.

Determining the transaction price (paragraphs 50–67)

- BC127 Determining the transaction price is an important step in the revenue recognition model because the transaction price is the amount that an entity allocates to the separate performance obligations in a contract (ie for a contract with more than one performance obligation). The transaction price is also an input to the onerous test (see paragraphs BC204–BC216).

- BC128 The boards decided to define the transaction price as the amount of consideration that an entity expects to be entitled to receive in exchange for transferring goods or services. Therefore, the objective in determining the transaction price at each reporting date is to predict the total amount of consideration that the entity will be entitled to receive from the contract.
- BC129 In the light of feedback on the 2010 exposure draft, the boards clarified that the transaction price would include only amounts (including variable amounts) to which the entity has rights under the present contract. For example, the transaction price does not include estimates of consideration from (a) the future exercise of options for additional goods or services or (b) future change orders. Until the customer exercises the option or agrees to the change order, the entity does not have a right to consideration. Additionally, the boards observed that in some industries (for example, the healthcare industry), there may be a difference between the contractually stated price for a good or service (for example, a list price) and the amount of consideration to which the entity expects to be entitled in accordance with its customary business practice of accepting a reduced amount of consideration as payment in full from customers (or a class of customers).
- BC130 Determining the transaction price when a customer promises to pay a fixed amount of cash consideration will be simple. However, determining the transaction price may be more difficult in the following cases:
- (a) the promised amount of consideration is variable (paragraphs BC131–BC142);
 - (b) the contract has a financing component that is significant to the contract (ie time value of money, paragraphs BC143–BC156);
 - (c) the promised amount of consideration is in a form other than cash (ie non-cash consideration, paragraphs BC157–BC158); and
 - (d) there is consideration payable to the customer (paragraphs BC159–BC162).

Variable consideration (paragraphs 53–57)

- BC131 The 2010 exposure draft proposed that when the consideration in a contract is variable, an entity should measure the transaction price (at its expected value) using a probability-weighted method. A probability-weighted method reflects the full range of possible consideration amounts, weighted by their respective probabilities.

- BC132 Many respondents to the 2010 exposure draft disagreed with measuring the transaction price using a probability-weighted method because they thought it would:
- (a) be complex and costly to apply; and
 - (b) not generate meaningful results in all circumstances because, for example, it could result in an entity determining the transaction price at an amount of consideration that the entity could never obtain under the contract.
- BC133 Some respondents suggested that the boards not specify a measurement model and instead require that the transaction price be determined using 'management's best estimate'. Many thought this would provide management with the flexibility to make an estimate on the basis of its experience and available information, without the documentation that would be required when a measurement model is specified.
- BC134 In their re-deliberations, the boards first affirmed their decision in the 2010 exposure draft to specify an objective and appropriate measurement method(s) for estimating the transaction price. This is because specifying an objective and measurement methods would provide the necessary framework to ensure rigour in the process of estimation. Furthermore, without such a framework, the measurement of revenue might not be understandable to users and might lack comparability between entities.
- BC135 However, the boards then reconsidered the measurement model in the proposed requirements. They noted that a probability-weighted method reflects all of the uncertainties existing in the transaction price at the reporting date. Therefore, it best reflects the conditions that are present at each reporting date. For instance, it reflects the possibility of receiving a greater amount of consideration as well as the risk of receiving a lesser amount. However, in re-deliberations, the boards observed that users are most interested in knowing the total amount of consideration that ultimately will be realised from the contract. Therefore, the boards decided that for the estimate of the transaction price to be meaningful at each reporting date, it should be an amount that the entity expects to better predict the amount of consideration to which it will be entitled.
- BC136 The boards observed that, in some cases, a probability-weighted estimate (ie an expected value) is predictive of the amount of consideration to which an entity will be entitled. For example, that is likely to be the case if the entity has a large number of contracts with similar characteristics. However, the boards agreed with respondents that an expected value may not always be predictive of the consideration to which an entity will be

entitled. For example, if the entity is certain to receive one of only two possible consideration amounts, the expected value would not be a possible outcome in accordance with the contract. The boards decided that in those cases, another method, the most likely method, would be necessary to estimate the transaction price. That is because the most likely method identifies the individual amount of consideration in the range of possible consideration amounts that is more likely to occur than any other individual outcome.

BC137 Therefore, the boards decided to specify that an entity should estimate either the expected value or most likely amount to estimate the transaction price, depending on which method the entity expects will better predict the amount of consideration to which the entity will be entitled.

BC138 Although in theory, an entity using the most likely method must consider all the possible outcomes to identify the most likely one, in practice, there is no need to quantify the less probable outcomes. Similarly, in practice, estimating the expected value using a probability-weighted method does not require an entity to consider all possible outcomes using complex models and techniques, even if an entity has extensive data and can identify many outcomes. In many cases, a limited number of discrete outcomes and probabilities can often provide a reasonable estimate of the distribution of possible outcomes. Therefore, the boards decided that neither of the two approaches should be too costly or complex to apply.

Subsequent changes in the transaction price

BC139 After contract inception, an entity revises its expectations about the amount of consideration to which it expects to be entitled as uncertainties are resolved or as new information about remaining uncertainties becomes available. To depict conditions that exist at each reporting date (and changes in conditions during the reporting period), the boards decided that an entity should update its estimate of the transaction price throughout the contract. The boards believe that reflecting current assessments of the amount of consideration to which the entity expects to be entitled would provide more useful information to users than retaining the initial estimates, especially for long-term contracts that are subject to significant changes in conditions during the life of the contract.

BC140 The boards considered whether, if the transaction price changes during a contract, an entity should:

- (a) recognise those changes in profit or loss when those changes occur; and
 - (b) allocate those changes to performance obligations.
- BC141 The boards rejected the alternative of recognising the entire amount of a change in the estimate of the transaction price in profit or loss when that change occurs. In the boards' view, that alternative could result in a pattern of revenue recognition that does not faithfully depict the pattern of the transfer of goods or services. Moreover, recognising revenue immediately (and entirely) for a change in the estimate of the transaction price would be prone to abuse in practice. The boards considered whether changes in the estimate of the transaction price could be presented as a gain or loss separately from revenue, thus preserving the pattern of revenue recognition. However, the boards rejected that alternative because the total amount of revenue recognised for the contract would not equal the amount of consideration to which the entity was entitled under the contract.
- BC142 Instead, the boards decided that an entity should allocate a change in the transaction price to all the performance obligations in the contract, subject to the conditions in paragraph 76 of the proposed requirements (discussed further in paragraphs BC186–BC189 and BC192). That is because the cumulative revenue recognised would then depict the revenue that the entity would have recognised if, at contract inception, it had had the information that was available at the subsequent reporting date. Consequently, the transaction price that is allocated to performance obligations that have already been satisfied would be recognised as revenue (or as a reduction of revenue) immediately.

Time value of money (paragraphs 58–62)

- BC143 Some contracts with customers include a financing component. The financing component may be explicitly identified in the contract or may be implied by the payment terms of the contract.
- BC144 Paragraph 58 of the proposed requirements specifies that an entity should account for the effects of the time value of money in a contract with a customer only if that contract includes a financing component that is significant to the contract. A contract has a financing component if the promised amount of consideration differs from the cash-selling price of the promised goods or services. In that case, the transaction price would be calculated as the nominal amount of customer consideration adjusted for the effects of the time value of money. The transaction price would be allocated to the performance obligations in the contract and, when a

performance obligation is satisfied, the amount of revenue recognised would be the amount of the transaction price adjusted for the financing—in effect, the ‘cash selling price’ of the underlying good or service at the time the good or service is transferred. The boards noted that for some types of goods or services, such as prepaid phone cards and customer loyalty points, the customer will pay for those goods or services in advance and the transfer of those goods or services to the customer is at the discretion of the customer. Consequently, in those cases, the boards expect that those contracts would not include a financing component that is significant because, on an individual contract basis, the entity does not know when the goods or services will transfer to the customer.

BC145 The boards decided that an entity should account for the effects of the time value of money if a contract has a financing component that is significant for the following reasons:

- (a) entities are not indifferent to the timing of the cash flows in a contract. Therefore, reflecting the time value of money portrays an important economic feature of the contract. A contract in which the customer pays for a good or service when that good or service is transferred to the customer is different from a contract in which the customer pays significantly before or after the good or service is transferred.
- (b) not recognising the financing component could misrepresent the profit of a contract. For example, if a customer pays in arrears, ignoring the financing component of the contract would result in full profit recognition on the transfer of the good or service, despite the ongoing cost to the entity of providing financing to the customer.
- (c) contracts with explicitly identified financing components would be accounted for consistently with contracts in which the financing component is implicit in the contract price.

BC146 For many contracts, an entity would not need to adjust the amount of customer consideration because the effects of the time value of money would not materially change the amount of revenue that should be recognised in relation to a contract with a customer. In other words, for those contracts, the financing component would not be significant. During their re-deliberations, the boards clarified that an entity would only need to consider the *significance* of a financing component at a contract level, rather than whether the financing is *material* at a portfolio level. The boards decided that it would be unduly burdensome to require

an entity to account for a financing component if the effects of the time value of money are not material to the individual contract but the combined time value of money effect for a portfolio of similar contracts would be material to the entity as a whole.

- BC147 During their re-deliberations, the boards also clarified when a financing component is significant to the contract. The 2010 exposure draft suggested that a financing component that is significant to the contract would arise whenever payment is due either significantly before or significantly after the transfer of goods or services to the customers. However, in the light of responses to the 2010 exposure draft, the boards agreed that the length of time between performance and payment should not necessarily be the only factor that determines whether a contract includes a financing component that is significant. Instead, the boards identified other factors (listed in paragraph 59) that indicate that a contract has a financing component that is significant. One of those factors refers to the typical credit terms in an industry and jurisdiction because, in some circumstances, a payment in advance or in arrears in accordance with the typical payment terms of an industry or jurisdiction may have a primary purpose other than financing. For example, a customer may retain or withhold an amount of consideration that is payable only on successful completion of the contract or on achievement of a specified milestone. The purpose of such payment terms may be primarily to provide the customer with assurance that the entity will satisfactorily complete their obligations under the contract, rather than to provide financing to the customer. Consequently, the effects of the time value of money may not be significant in those circumstances.

Exceptions to accounting for the effects of the time value of money

- BC148 Some existing standards require an entity to recognise the effects of financing only if the time period exceeds a specified period, often one year. For example, ASC paragraph 835-30-15-3 excludes those 'transactions with customers or suppliers in the normal course of business that are due in customary trade terms not exceeding approximately one year'. The boards decided to include similar relief from the requirement to account for a financing component that is significant to the contract. The boards noted that the relief could produce arbitrary outcomes in some cases because the time value of money could be material for short-term contracts with high implicit interest rates and, conversely, may be

immaterial for long-term contracts with low implicit interest rates. However, the boards were persuaded to exempt entities from accounting for the effects of the time value of money on contracts with an expected duration of one year or less for the following reasons:

- (a) compliance with the revenue standard would be simplified. This is because an entity would not be required to:
 - (i) conclude whether those contracts contain the attributes of a financing component that is significant to the contract (as outlined in paragraphs BC146 and BC147 above).
 - (ii) determine the interest rate that is implicit within those contracts.
- (b) the effect on the pattern of profit recognition should be limited because the exemption includes only those implicit financing arrangements that are expected to expire no later than during the following annual reporting period (ie when either the customer pays or the entity performs).

BC149 Some respondents also suggested that the boards should exempt an entity from reflecting in the measurement of the transaction price the effects of the time value of money associated with advance payments from customers. Those respondents commented that accounting for any effects of the time value of money arising from advance payments would:

- (a) represent a change from existing practices in which an entity typically does not recognise the time value of money implicit in advance payments;
- (b) 'gross up' revenue (for example, if the discount rate implicit in the contract resulted in the accretion of interest of CU21 over 2 years, revenue would be recognised at the amount of the CU121 rather than the CU100 paid in advance); and
- (c) not reflect the economics of the arrangement when the customer pays in advance for reasons other than financing (for example, the customer is a credit risk or is compensating the entity for incurring upfront contract costs).

BC150 The boards decided not to exempt entities from accounting for the time value of money effects of advance payments because ignoring the time value of money effects of advance payments could substantially skew the amount and pattern of profit recognition if the advance payment is large and occurs well in advance of the transfer of the goods or services to the customer.

Discount rate

- BC151 The boards considered whether the discount rate used to reflect the financing should be the risk-free rate or a risk-adjusted rate. A risk-free rate would be observable and simple to apply, and it would avoid the costs of determining a rate specific to each contract. However, the boards decided that using the risk-free rate would not result in useful information because the resulting interest rate would not reflect the characteristics of the parties to the contract. In addition, the boards noted that it would not necessarily be appropriate to use any rate explicitly specified in the contract because the entity might offer 'cheap' financing as a marketing incentive and, hence, using that rate would not result in an appropriate recognition of profit over the life of the contract. Therefore, the boards decided that an entity should use the rate that would be used in a financing transaction between the entity and its customer that did not involve the provision of goods or services, because that rate would reflect the characteristics of the party receiving financing in the contract. That rate also would reflect the customer's creditworthiness, among other risks.
- BC152 Some respondents to the 2010 exposure draft mentioned that determining the discount rate that would be used in a separate financing between an entity and the customer would be difficult and costly because most entities within the scope of the revenue standard do not enter into separate financing transactions with their customers. In addition, it would be impractical for entities with large volumes of customer contracts to determine a discount rate specifically for each individual customer.
- BC153 In many cases, the boards expect that those concerns would be addressed because the one-year exemption would apply. For those remaining contracts in which the entity is required to account separately for the financing component, the boards expect that the entity and the customer would typically negotiate the contractual payment terms separately after considering factors such as inflation rates and the customer's credit risk. Hence, an entity should have access to sufficient information to determine the discount rate that would be used in a separate financing between an entity and the customer.

Re-evaluation of the effects of the time value of money

- BC154 The 2010 exposure draft did not specify whether an entity should re-evaluate the effects of the time value of money after the initial measurement of the transaction price. However, some respondents questioned whether an entity would be required to revise that measurement for a change in circumstances.
- BC155 The boards clarified that an entity should not update the discount rate for a change in circumstances because they decided that an entity should reflect in the measurement of the transaction price only the discount rate that is implicit in the contract at contract inception. They also observed that it would be impractical for an entity to update the transaction price for changes in the assessment of the discount rate. However, the boards noted that an entity would re-evaluate the effects of the time value of money when there is a change in the estimated timing of the transfer of goods or services to the customer.

Presentation of the effects of the time value of money

- BC156 The boards decided that an entity should present the effects of the financing (ie the unwinding of the discount) separately from revenue as interest income or interest expense, rather than as a change to the measurement of revenue. That is because contracts with financing components that are significant have distinct economic characteristics—one relating to the transfer of goods or services to the customer and another relating to a financing arrangement—and those characteristics should be accounted for and presented separately.

Non-cash consideration (paragraphs 63 and 64)

- BC157 When an entity receives cash from a customer upon delivery of a good or service, the transaction price and, hence, the amount of revenue, is the amount of cash received—ie the value of the inbound asset. To be consistent with that approach when the customer pays non-cash consideration (for example, goods or services), the boards decided that the entity should also measure non-cash consideration (or promises of non-cash consideration) at fair value.
- BC158 The boards decided that if an entity cannot reasonably estimate the fair value of the non-cash consideration, it should measure the promised consideration indirectly by reference to the selling price of the goods or services promised in exchange for the consideration. That approach is consistent with both requirements in some existing revenue standards (for example, IAS 18) and requirements for other situations in which the

fair value of the assets surrendered in exchange for assets received may be estimated more reliably. (For instance, IFRS 2 *Share-based Payment* and ASC Section 505-50-30 on the initial measurement of equity-based payments to non-employees state that if the fair value of the goods or services received cannot be estimated reliably, then the entity measures them indirectly by reference to the fair value of the granted equity instrument.)

Consideration payable to the customer (paragraphs 65–67)

- BC159 In some cases, an entity pays consideration to one of its customers or to other parties that purchase the entity's goods or services from its customers (for example, an entity may sell a product to a dealer or distributor and subsequently make a payment to a customer of that dealer or distributor). That consideration might be a payment in exchange for goods or services received from the customer, a discount or refund for goods or services provided to the customer or a combination of both.
- BC160 To help an entity distinguish between those types of payments, the boards decided that an entity should account for any good or service received in the same way as for other purchases from suppliers only if the good or service is distinct, using the same criteria proposed to identify a separate performance obligation. Existing guidance in US GAAP (ASC paragraph 605-50-45-2) on vendor's consideration given to a customer uses the term 'identifiable benefit', which is described as a good or service that is 'sufficiently separable from the recipient'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'. The boards think that the principle in the proposed requirements for assessing whether a good or service is distinct is similar to the existing guidance in US GAAP.
- BC161 Regardless of whether they are separate events, the amount of consideration received from the customer for goods or services and any payment of consideration to that customer for goods or services could be linked. For instance, a customer may pay more for goods or services from the entity than it otherwise would have paid if it was not receiving a payment from the entity. Therefore, to depict revenue faithfully in such cases, the boards decided that any amount accounted for as a payment to the customer for goods or services received should be limited to the fair value of those goods or services, with any amount in excess of the fair value recognised as a reduction to the transaction price.

BC162 If the payment of consideration is accounted for as a reduction of the transaction price, the entity would recognise less revenue when it satisfies the related performance obligation(s). However, in some cases, an entity promises to pay consideration to a customer only after the entity has satisfied the performance obligation and, hence, after it has recognised revenue. Accordingly, the boards propose clarifying that the reduction to revenue is recognised at the later of when the entity transfers the goods or services to the customer or when the entity promises to pay the consideration. By using the phrase ‘promises to pay’, the boards intend to clarify that an entity should reflect in the transaction price payments to customers that are conditional on future events (for example, a payment to a customer conditional on the customer making a specified number of purchases).

Collectibility (paragraphs 68 and 69)

BC163 The core principle of the proposed requirements is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In developing the 2010 exposure draft, the boards considered how an entity should account for any uncertainty arising from the possibility that the customer may be unable to pay—ie uncertainty about the collectibility of the promised consideration.

BC164 The 2010 exposure draft proposed that an entity should recognise revenue at the amount that the entity expects to *receive* from the customer. In other words, the customer’s credit risk would be reflected in the measurement of the transaction price that is allocated to the separate performance obligations in the contract. The boards reached that conclusion in the 2010 exposure draft after considering whether an entity’s assessment of collectibility should affect either or both of the following:

- (a) the recognition of revenue (ie whether an entity recognises revenue when a good or service is transferred); and
- (b) the amount of revenue (ie how much revenue an entity recognises when a good or service is transferred).

BC165 The boards’ proposal on collectibility was one of the topics on which respondents to the 2010 exposure draft most commented. Although some respondents agreed with the concept of the transaction price reflecting the customer’s credit risk, nearly all respondents (including

preparers, users and securities regulators) expressed concerns about applying that concept in practice. After considering that feedback, the boards decided not to adopt that proposal in the 2010 exposure draft. Instead, the boards propose the following:

- (a) revenue should be recognised at the amount to which the entity expects to be *entitled*;
- (b) the requirements for the recognition of revenue should not include a specific threshold for expectations about the collectibility of the promised consideration; and
- (c) any impairment losses (and reversals) should be presented as a separate line item adjacent to the revenue line item.

BC166 The boards' rationale for those decisions is explained in the paragraphs below.

Recognising revenue at the amount to which the entity expects to be entitled

BC167 The boards propose that revenue should be measured at the amount to which the entity expects to be entitled, which therefore would not reflect any adjustments for amounts that the entity may not be able to collect from the customer. In reaching that decision, the boards were persuaded by users of financial statements who commented that they would prefer that revenue be measured at that 'gross' amount so that revenue growth and receivables management (or bad debts) can be analysed separately. Those users are interested in assessing the performance of an entity's sales function and receivables collection function separately because they are often managed separately. However, that information would not be available if an entity's assessment of sales and collectibility were only reflected on a 'net' basis in the revenue line.

A separate recognition threshold

BC168 The proposed requirements do not specify a threshold for expectations of collectibility that must be passed before revenue can be recognised. This represents a change from the requirements in some existing standards, which address collectibility through recognition. For example, ASC Section 605-10-S99 (SEC Staff Accounting Bulletin Topic 13 *Revenue Recognition*) states that revenue can be recognised only if 'collectibility is reasonably assured'. In IFRSs, IAS 18 specifies that revenue is recognised only when 'it is probable that the economic benefits associated with the transaction will flow to the entity'.

BC169 Instead, the boards propose to address concerns about collectibility by requiring the following:

- (a) the contract with a customer should have commercial substance (as discussed in paragraph BC34); and
- (b) any impairment losses should be presented as a separate line item adjacent to the revenue line so that those losses on contracts with customers can be easily compared with the revenue recognised (as discussed in paragraphs BC171–BC173).

BC170 In reaching that conclusion, the boards noted the following consequences of having collectibility as a recognition criterion:

- (a) the boards would need to specify a probability threshold (for example, reasonably assured or probable) that must be passed before revenue would be recognised.
- (b) in many cases, collectibility is assessed at a portfolio level because an entity typically does not know which customers will default. Consequently, a revenue recognition hurdle may be difficult to apply to individual contracts.
- (c) it would be inconsistent with the accounting for a receivable, which incorporates assessments of collectibility in the measurement of that financial asset.

Presentation of the effects of a customer's credit risk

BC171 The boards propose that an entity should present any impairment losses from contracts with customers adjacent to the revenue line in profit or loss (subject to the usual materiality considerations for line item disclosure). The boards noted that their decision on presentation typically only changes the location of the line item for impairment losses arising from contracts with customers. The proposed requirements do not include any changes to the recognition and measurement of impairment losses of financial assets, such as trade receivables. Instead, an entity would recognise and measure the impairment loss in accordance with IFRS 9 *Financial Instruments* or ASC Topic 310 on receivables. (In addition, the boards have a separate project that is currently considering improvements to the impairment models in those standards.) Because impairment is a measurement issue that arises after initial recognition of an asset, the boards decided that the proposed requirements should also specify the accounting for any difference between the amount of revenue that has been recognised and the corresponding initial measurement of the receivable. The boards decided

that any loss that arises on initial recognition of the receivable should be presented adjacent to the revenue line in profit or loss similarly with any impairment losses. The boards expect that an entity would typically not recognise a loss on initial recognition because the receivable normally would initially be measured at the original invoice amount if the contract with a customer does not include a financing component that is significant.

- BC172 The boards agreed to link the presentation of the revenue line and the impairment loss line so that it is transparent to all users of financial statements that a portion of the entity's gross revenue is expected to be uncollectible. A consequence of that decision is that impairment losses that are presented as a separate line item adjacent to the revenue line item may relate to amounts of uncollectible consideration that was recognised as revenue in previous reporting periods. Although there is not necessarily a connection between the revenue recognised in a particular reporting period and the impairment losses recognised in that period, presenting the impairment loss adjacent to revenue facilitates users' understanding of the amounts that an entity ultimately expects to receive from the customer. In addition, the boards noted that for some industries (for example, healthcare), it can be difficult to distinguish a billing adjustment (which would be presented as an adjustment to revenue) from other credit adjustments (which historically are presented as expenses).
- BC173 Another consequence of that decision is that impairment losses on trade receivables arising from contracts with customers would be presented differently from all other financial assets that are subject to impairment. This is because the impairment loss for the trade receivable would be presented adjacent to revenue, whereas for all other financial assets, impairment loss would be presented together with other expense items in the statement of comprehensive income. For the reasons explained in paragraphs BC174 and BC175, those other financial assets would include receivables arising from contracts with customers that include a financing component that is significant to the contract.

Credit risk in contracts with a financing component that is significant to the contract

- BC174 The effect of the boards' decision on the time value of money (see paragraphs BC143–BC156) is that a contract with a customer that has a financing component that is significant to the contract would be bifurcated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred payment terms). The

revenue component would be within the scope of the revenue standard, and the loan component would be within the scope of the financial instruments standards. Consequently, bifurcating the contract means that the accounting for a trade receivable arising from a contract with a customer that has a financing component that is significant to the contract should be comparable to the accounting for a loan with the same features. Consider the following example: Customer A purchases a good on credit and must pay CU1,000 in 3 years. The present value of this trade receivable is CU751. Now consider Customer B who borrows CU751 from a bank with a promise to pay CU1,000 in 3 years. Customer B uses the loan to purchase the same good as Customer A. Economically, these transactions are the same but, in the absence of the proposed requirements, the form of the transaction would determine whether the financing component would be accounted for as a trade receivable or as a loan. For this reason, paragraph 58 of the proposed requirements would require a contract (with a financing component that is significant to the contract) to be bifurcated, which would result in the same accounting for the financing elements of both transactions.

- BC175 A contract that has a financing component that is significant to the contract includes, in concept, two transactions—one for the sale and another for the financing. The presentation of any impairment losses from long-term trade receivables (ie receivables arising from the financing components of contracts with customers) would be consistent with the presentation of impairment losses for other types of financial assets within the scope of the financial instruments standards. Although this means that impairment losses would be presented differently for long-term trade receivables than for short-term trade receivables (ie receivables arising from contracts with customers that do not have separately identified financing components), that outcome follows naturally from the boards' decision to propose that an entity account for the effects of the time value of money if the financing component is significant to the contract.

Allocating the transaction price to separate performance obligations (paragraphs 70–80)

- BC176 In the 2010 exposure draft, the boards proposed that an entity should allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception (ie on a relative stand-alone selling price basis). They decided that an allocation based on stand-alone selling prices would faithfully depict the different margins that may apply to promised goods or services.
- BC177 Most respondents to the 2010 exposure draft agreed with the proposal to allocate the transaction price on a relative stand-alone selling price basis. In addition, the 2010 exposure draft was broadly consistent with recent changes to US GAAP (Update 2009-13) to account for multiple-deliverable revenue arrangements. However, respondents expressed concerns about the following topics:
- (a) estimating the stand-alone selling price; and
 - (b) allocating discounts and contingent consideration.

Estimating stand-alone selling prices (paragraph 73)

- BC178 Consistent with the 2010 exposure draft, the proposed requirements specify that if an entity does not have an observable price from selling a good or service separately, the entity should estimate the stand-alone selling price.
- BC179 The boards affirmed the proposal in the 2010 exposure draft to indicate suitable estimation methods in paragraph 73 of the proposed requirements. The boards also affirmed that they do not intend to preclude or prescribe any particular method for estimating a stand-alone selling price so long as the estimate is a faithful representation of the price at which the entity would sell the distinct good or service if it were sold separately to the customer. However, the boards clarified that the method used by the entity to estimate a stand-alone selling price should maximise the use of observable inputs and should be applied consistently to estimate the stand-alone selling price of other goods or services with similar characteristics.
- BC180 The boards observed that many entities may already have robust processes for determining stand-alone selling prices on the basis of reasonably available data points and the effects of market considerations and entity-specific factors. However, other entities may need to develop

processes for estimating selling prices of goods or services that are typically not sold separately. The boards decided that when developing those processes, an entity should consider all reasonably available information on the basis of the specific facts and circumstances. That information might include the following:

- (a) reasonably available data points (for example, a stand-alone selling price of the good or service, the costs incurred to manufacture or provide the good or service, related profit margins, published price listings, third-party or industry pricing, and the pricing of other goods or services in the same contract);
- (b) market conditions (for example, supply and demand for the good or service in the market, competition, constraints and trends);
- (c) entity-specific factors (for example, business pricing strategy and practices); and
- (d) information about the customer or class of customer (for example, type of customer, geography and distribution channel).

Residual approach

BC181 In the 2010 exposure draft, the boards proposed that the residual method should not be used to allocate the transaction price to separate performance obligations. However, in the accompanying Basis for Conclusions, the boards noted that a residual (or reverse residual) approach might be a suitable technique for estimating a stand-alone selling price if there is a directly observable price for one performance obligation but not the other. Under the residual approach, an entity would determine a stand-alone selling price of a good or service on the basis of the difference between the total transaction price and the stand-alone selling prices of other goods or services in the contract.

BC182 Respondents to the 2010 exposure draft generally agreed that, in some circumstances, it might be appropriate to use a residual approach to estimate a selling price. However, those respondents thought that the proposed requirements should clarify how and when an entity could use the residual approach as an estimation method. Therefore, paragraph 73(c) of the proposed requirements specifies the circumstances in which a residual approach would be a suitable method to estimate a stand-alone selling price. In specifying those circumstances, the boards were particularly mindful of the challenges in determining stand-alone selling prices in contracts for intellectual property and other intangible products, in which the pricing can be highly variable because there is

little or no incremental cost to the entity in providing those goods or services to a customer. In those circumstances, the most reliable way of determining the stand-alone selling price in the contract will often be to use a residual approach. For the same reason, the boards noted that the residual approach might be appropriate in situations in which an entity has not yet established the selling price for a good or service that has not previously been sold.

Specifying a hierarchy of evidence

- BC183 Most respondents agreed with the boards' proposal in the 2010 exposure draft for not prescribing a hierarchy of evidence for estimating a stand-alone selling price. However, some respondents recommended that the boards specify a hierarchy of evidence to determine the stand-alone selling price of a separate performance obligation similar to the following hierarchy in ASC Subtopic 605-25:
- (a) if vendor-specific objective evidence of a selling price is available, it would be used to determine the selling price of a promised good or service.
 - (b) if vendor-specific objective evidence is not available, an entity would determine the selling price using third-party evidence, if available.
 - (c) if third-party evidence is not available, then an entity would use its best estimate of selling price.
- BC184 Those respondents indicated that specifying a hierarchy of evidence for determining stand-alone selling prices (and requiring disclosures using that hierarchy) would enhance the quality and reliability of an entity's reported revenues.
- BC185 The boards observed that under the proposed requirements, an entity should use observable prices when a good or service is sold separately by the entity (similar to a vendor-specific objective evidence notion). It is only when a good or service is not sold separately that an entity would estimate selling prices. And, in that estimation process, an entity would still be required to maximise the use of observable inputs. The boards observed that there is little distinction between third-party evidence and a best estimate of selling price in the above hierarchy in ASC Subtopic 605-25. For instance, third-party evidence of a selling price might require adjustments to reflect differences either in (a) the good or service (because the third-party price could be for a similar, rather than identical, good or service) or (b) pricing strategies between the third party and the

entity. Hence, the boards affirmed their proposal in the 2010 exposure draft not to specify a hierarchy. Instead, the boards decided that it was important to emphasise that an entity should maximise the use of observable inputs when developing estimates of stand-alone selling prices.

Allocating discounts and contingent consideration (paragraphs 74–76)

BC186 A consequence of allocating the transaction price on a relative stand-alone selling price basis is that any discount in the contract is allocated to all the separate performance obligations in the contract. Some respondents to the 2010 exposure draft thought that this would not always faithfully depict the amount of consideration to which an entity is entitled on satisfying a particular performance obligation. For instance, they noted that the allocation of the discount could result in a loss on one part of the contract if the contract as a whole is profitable (for example, the contract contains both a high margin item and a low margin item). They suggested that the boards permit an entity to allocate the discount in a contract using one of the following alternatives:

- (a) a management approach, whereby an entity would assess which promised good or service is priced at a discount to its stand-alone selling price;
- (b) a residual approach, whereby any discount in the contract would be allocated entirely to the satisfied performance obligations; or
- (c) a profit margin approach, whereby an entity would allocate the discount in a contract in proportion to the individual profit margin on each performance obligation. The individual profit margin for each performance obligation is the difference between the stand-alone selling price and the direct costs of the good or service underlying each separate performance obligation.

BC187 Another consequence of allocating the transaction price on a relative stand-alone selling price basis is that any amount of the consideration that is contingent on a future event or circumstance is allocated to all the separate performance obligations in the contract. Some respondents to the 2010 exposure draft thought that this would not always faithfully depict the amount of consideration to which an entity is entitled on satisfying a particular performance obligation. Many suggested that such contingent amounts should be allocated only to the performance obligation(s) to which they relate.

- BC188 In re-deliberating the proposals in the 2010 exposure draft, the boards noted that the objective of the model is for an entity to recognise revenue in the amount of consideration to which the entity expects to be entitled from the customer in exchange for transferring goods or services. The relative stand-alone selling price basis allocation is simply a method to achieve that objective rather than the principle itself for allocating the transaction price.
- BC189 However, the boards also note that allocating the transaction price on a relative stand-alone selling price basis brings rigour and discipline to the process of allocating the transaction price and, therefore, enhances comparability both within an entity and across entities. Therefore, the boards decided that it should be the default method for allocating the transaction price. However, they agreed with respondents that it might not always result in a faithful depiction of the amount of consideration to which the entity expects to be entitled from the customer. Accordingly, in the proposed requirements, the boards have specified when other methods should be used.

Allocating discounts (paragraphs 74 and 75)

- BC190 The 2010 exposure draft acknowledged that in some cases it would be inappropriate to allocate a discount to all the separate performance obligations in a contract. Hence, the 2010 exposure draft included a 'contract segmentation' principle that would restrict the allocations of discounts on the basis of goods or services that are priced independently (discussed in paragraph BC49). Many respondents to the 2010 exposure draft agreed with the objective of the contract segmentation principle. However, most thought that the objective could be better met by incorporating the principle into the allocation process. Accordingly, the boards have largely carried forward into the proposed requirements the notion that an entity should allocate a discount to one or more separate performance obligations, rather than to all the performance obligations, if the entity has observable sales prices for parts of the contract that establish that the entire discount in the contract is attributable only to one or more separate performance obligations.
- BC191 The boards rejected the other alternatives suggested by respondents. The boards decided that the transaction price is for the contract as a whole. Therefore, unless the price of some promised goods or services in the contract is largely independent of the price of other promised goods or services, any discount in the contract would be attributable to the contract as a whole and should be allocated proportionally to all the separate performance obligations in the contract. In addition, the

boards noted that the profit margin method would require an entity to estimate the costs to satisfy a performance obligation. Apart from creating additional complexity, the boards were concerned that different treatments in the way costs are allocated to performance obligations could significantly affect how the transaction price is allocated.

Allocating contingent consideration (paragraph 76)

BC192 The boards agreed with respondents that it would not always be appropriate for an entity to allocate amounts that are contingent on future events or circumstances to all the performance obligations in a contract. For example, an entity may contract to provide two products at different times with a variable amount contingent upon the timely delivery of the second product. In such an example, it might not be appropriate to attribute the variable amount to both the products. Therefore, the boards specified the criteria in paragraph 76 to identify the circumstances in which an entity should allocate the variable consideration entirely to a distinct good or service rather than all of the distinct goods or services. The boards decided that those criteria were necessary to ensure that the contingent amount relates to the entity's efforts to transfer the good or service and that the allocation of the variable consideration entirely to a distinct good or service is reasonable relative to all of the other performance obligations and payment terms in the contract.

Contingent revenue cap

BC193 Some respondents to the 2010 exposure draft disagreed with the boards' proposal that the transaction price should be allocated on a relative stand-alone selling price basis. Those respondents (primarily from the telecommunications and cable television industry) requested that, instead, the boards carry forward the contingent revenue allocation guidance from ASC Subtopic 605-25 (often described as the contingent revenue cap). (There are no equivalent requirements in IAS 18, although in practice the boards understand that most telecommunications entities that apply IFRSs account for their contracts in a similar manner as entities that apply US GAAP.)

BC194 The contingent revenue cap limits the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future (or meeting other specified performance conditions). For example, under those requirements, the amount of consideration that a telecommunications entity can allocate to a handset that is bundled with

network services is limited to the amount that is not contingent on the delivery of network services in the future. Hence, when the handset is transferred to the customer, revenue is recognised at the amount that the customer paid for the handset at contract inception. The remaining contractual payments are recognised subsequently as revenue as the entity provides network services to the customer.

- BC195 Respondents from the telecommunications industry observed that without a contingent revenue cap, revenue would be recognised for delivering a handset in an amount that exceeds the amount of consideration paid for the handset. These respondents do not think this is appropriate because they would be entitled to collect the excess only when they provide the network services. Therefore, they reasoned that the contract asset that results from recognising revenue for delivery of the handset does not meet the definition of an asset. Additionally, they suggested that without a contingent revenue cap, the proposed model would be complex and costly to apply because of the high volume of contracts that they have to manage and the various potential configurations of handsets and network service plans.
- BC196 However, the boards affirmed their proposal in the 2010 exposure draft not to carry forward the contingent revenue cap for the following reasons:
- (a) limiting the amount of consideration that can be allocated to a satisfied separate performance obligation is tantamount to cash-basis accounting and does not meet the core principle of the proposed requirements. That is because revenue recognised would not depict the amount of consideration to which the entity expects to be entitled for the delivered good or service. Consequently, the contingent revenue cap could result in economically similar contracts being accounted for differently.
 - (b) the contingent revenue cap can result in the recognition of losses when the contract is profitable. That would occur when the amount allocated to a satisfied performance obligation is constrained (potentially to zero) to an amount that is less than the expenses recognised for the costs of providing the good or service (unless those costs are deferred). However, costs relating to a good or service already transferred to the customer would not give rise to an asset.
 - (c) recognising a contract asset in the situation described in paragraph BC195 is appropriate because the entity clearly has a valuable contractual right as a result of satisfying a performance obligation

and that right meets the definition of an asset. That right exists even if the entity does not have the present right to collect consideration from the customer. This is evidenced by the fact that if the entity were to transfer the remaining rights and performance obligations in the contract to a third party after it had delivered a handset, it would expect to be compensated for that past performance.

- (d) applying the contingent cap more broadly than it is applied in existing standards could have far-reaching consequences. For example, in many services contracts (including construction contracts), it is appropriate to recognise revenue when services are provided even though the amount of consideration is contingent on the entity's future performance. Otherwise, the entity would not recognise any revenue until reaching a contract milestone or potentially until completion of the contract (which would not depict the transfer of goods or services to the customer).
- (e) although the consequences on construction and other service contracts could be reduced by limiting the amount allocated to satisfied separate performance obligations (rather than limiting the amount allocated to a satisfied portion of a single performance obligation), the boards decided that this would create an arbitrary distinction and put additional pressure on the criteria for identifying separate performance obligations.
- (f) for many contracts that are currently accounted for under the contingent revenue cap, the amount of consideration allocated to delivered items is not contingent because even if the customer cancels the contract, it would be obliged to pay for the delivered item(s). For example, in some contracts for the sale of a handset and network services, the contract is either not cancellable or, if it is, the customer is obliged to pay a termination fee that corresponds with the value of the handset delivered upfront (even if the entity chooses not to enforce payment of that fee).

BC197 Additionally, the boards decided not to introduce an exception to the revenue model for telecommunications and similar contracts because they do not view those contracts to be unique. Furthermore, the boards decided that the proposed requirements would provide a more consistent basis for recognising revenue and would produce results in accounting that more closely match the underlying economics of transactions.

Constraint on the cumulative amount of revenue recognised (paragraphs 81–85)

- BC198 The 2010 exposure draft proposed that an entity should recognise revenue from satisfying a performance obligation only if the transaction price could be reasonably estimated. The boards then specified the criteria that would have to be met to determine whether the transaction price could be reasonably estimated. The boards decided to include a constraint on the recognition of revenue because revenue is an important measure to users of financial statements when valuing an entity and because a significant portion of errors in financial statements have related to the overstatement or premature recognition of revenue.
- BC199 Most respondents supported a constraint on revenue recognition. However, some respondents noted some unintended consequences from the proposal to constrain the transaction price that would be allocated to all the performance obligations in the contract. In particular, respondents in the asset management industry noted that constraining the transaction price would not result in a pattern of revenue recognition that would faithfully depict their performance under the contract. In addition, respondents noted that if the transaction price is constrained, in some cases, an entity might not allocate any consideration to the remaining performance obligations in the contract. In such cases, those remaining performance obligations would be identified as onerous even though the entity expects those performance obligations to be profitable.
- BC200 Therefore, in the proposed requirements, the boards clarified that the constraint would apply when the promised amount of consideration in a contract is variable and only to the cumulative amount of revenue recognised to date for satisfied or partially satisfied performance obligations, rather than to the amount of consideration (ie the transaction price) allocated to all performance obligations.
- BC201 The boards also decided to specify that the cumulative amount of revenue an entity recognises should be limited to the amount to which the entity is reasonably assured to be entitled, rather than the amount that can be reasonably estimated. The primary reason for that change is that in some circumstances an entity might be able to reasonably estimate an amount even though the entity is not reasonably assured to be entitled to that amount in accordance with the proposed requirements. In other words, the boards decided that the term 'reasonably estimated' was appropriate in the context of the 2010 exposure draft when the boards proposed constraining the estimate of the overall transaction price. However, for

the purposes of constraining the amount of revenue that an entity would recognise, the boards decided that the term ‘reasonably assured’ would be a more appropriate label for describing the circumstances in which the amount of revenue should be constrained. The boards acknowledge that the constraint is a qualitative threshold, rather than a quantitative threshold and is not meant to include assessments of collectibility, which are considered separately (see paragraphs BC163–BC175).

Determining when the amount of revenue recognised is reasonably assured

BC202 The boards proposed criteria in the 2010 exposure draft for when revenue should be constrained. Most respondents agreed that the criteria were appropriate and useful. Therefore, the boards decided to carry forward those criteria with some modifications as described below. Those criteria, specified in paragraph 81, are as follows:

- (a) the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities)—an entity’s experience with similar types of performance obligations is necessary to be able to conclude that the amount of revenue recognised is reasonably assured. Without that experience, the level of uncertainty in the amount of revenue recognised would be too high for users to find that amount useful. In other words, a user might find it more useful if an entity were to recognise revenue only when the uncertainty is resolved. There may be circumstances in which an entity might not have such experience, such as for new offerings of goods or services or expansion into new markets. In those cases, the boards decided that another entity’s experience or other evidence may be a reasonable proxy for the entity’s own experience.
- (b) the entity’s experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations—an entity’s experience (or other evidence) is necessary, but not sufficient, for the entity to conclude that it is reasonably assured to be entitled to an amount of consideration. That experience also needs to be predictive of the amount of consideration to which the entity will be entitled, for example, because the entity does not expect significant changes in circumstances from its experience with similar performance obligations in the past. The boards modified this criterion from the 2010 exposure draft, which stated that an entity’s experience must be relevant, because they decided that the

term 'predictive' would better align with the objective of determining and allocating the transaction price (ie to allocate to each performance obligation the amount of consideration to which the entity expects to be entitled in exchange for satisfying those performance obligations). To help an entity assess whether its experience predicts the amount of consideration, the boards decided to specify the indicators in paragraph 82. Those indicators were derived in part from existing guidance in US GAAP on estimating sales returns. Those indicators were also proposed in the 2010 exposure draft.

- BC203 Some respondents expressed concern that the criteria for when revenue should be constrained would require an entity to recognise revenue when factors outside the entity's control could subsequently affect the amount of revenue recognised. For instance, with many sales-based royalties, an entity's performance occurs at the beginning of the contract, but the amount of consideration is based on the customer's subsequent sales of goods or services. In those cases, both users and preparers thought that it would not be useful for an entity to recognise revenue at the inception of the contract for the total amount of the consideration to which the entity expects to be entitled. That is because that approach inevitably would require the entity to report, throughout the life of the contract, significant adjustments to the amount of revenue recognised at inception of the contract as a result of changes in circumstances. For those contracts, users and preparers explained that the most useful information would be to recognise revenue when there is no longer uncertainty about the amount of consideration to which the entity is entitled. To address those concerns, the boards decided that for the circumstances described in paragraph 85 an entity should not recognise revenue for the uncertain amounts until the uncertainty is resolved (ie when the customer's subsequent sales occur). However, the boards emphasised that paragraph 85 would not preclude an entity from recognising revenue in *all* circumstances in which factors outside the entity's influence exist. Thus, for circumstances other than those in paragraph 85, an entity should consider the indicators in paragraph 82 to determine the amount of consideration to which the entity is reasonably assured to be entitled.

Onerous performance obligations (paragraphs 86–90)

- BC204 The proposed requirements specifies that an entity should recognise a liability for an onerous performance obligation that is satisfied over time and that the entity expects at contract inception to satisfy over a period of time greater than one year. The boards decided that an onerous test is a necessary component of a revenue model in which the initial measurements of performance obligations are not routinely updated. The onerous test provides users with important information by, in effect, remeasuring performance obligations to reflect significant adverse changes in circumstances.
- BC205 Some respondents agreed with the boards that the proposed revenue model should include an onerous test. However, a few respondents stated that performance obligations should never be remeasured and that losses on a contract should emerge over time as the revenue is recognised. In addition, some stated that a liability for an onerous performance obligation represents an accrual of costs and, therefore, is not related to revenue recognition. The boards disagreed with those views for the following reasons:
- (a) both IFRSs and US GAAP include an onerous test for some types of loss-making contracts (ie the consideration to be received must equal or exceed the expected costs to satisfy the performance obligations). Not having such a test would be a major change to current practice for some types of contracts.
 - (b) including the onerous test in the proposed requirements would achieve greater convergence between IFRSs and US GAAP on the margins reported from some contracts with customers.
 - (c) although the onerous test appears to be a liability recognition and measurement issue (because it results in the recognition of a separate liability that has no effect on the revenue recognition), conceptually, the onerous test is a (re)measurement issue, because there has been no new obligating event.
 - (d) the onerous test can be viewed as the mirror image for liabilities of an asset impairment test (ie a test to ensure that the amount of a performance obligation is not understated).

Unit of account

- BC206 Many respondents disagreed with the proposal in the 2010 exposure draft to apply the onerous test to individual performance obligations. Those respondents observed that applying the onerous test to individual performance obligations may not always generate meaningful information, in particular, because the onerous test would often require the recognition of a loss at contract inception for loss-making performance obligations even though the contract as a whole is expected to be profitable. Other respondents explained that their contracts are priced and profitability is assessed at a unit of account higher than the contract (or the remaining performance obligations) and, therefore, the unit of account for applying the onerous test should also be higher to correspond with how the entity manages those contracts.
- BC207 The boards considered, but rejected, changing the unit of account for the onerous test because they thought that it would add complexity and be inconsistent with recognising revenue at the performance obligation level. In addition, the boards noted that specifying the contract as the unit of account could be arbitrary because the unit of account would depend on whether the entity provides its goods or services in one contract or in more than one contract. Instead, the boards decided to address respondents' concerns on the unit of account by modifying the scope of the onerous test.

Scope of the onerous test

- BC208 The boards propose to limit the scope of the onerous test to performance obligations that are satisfied over time. Thus, a liability would be recognised when a performance obligation that is satisfied over time is determined to be onerous. As a practical expedient, the boards propose that an entity would apply the onerous test only to performance obligations that an entity expects at contract inception will be satisfied over a period of time that is greater than one year. In the boards' view, limiting the scope of the onerous test limits the risk of unintended consequences of applying the onerous test to some contracts. That is because the proposed scope is closest to the scope of existing revenue standards that specify an onerous test (ie IAS 11 and ASC Subtopic 605-35).

- BC209 In addition, limiting the scope of the onerous test would address some cost-benefit concerns because it would minimise the amount of additional effort needed for an entity to apply the test. When a performance obligation is satisfied over time, an entity is already required to measure progress towards complete satisfaction of that performance obligation, which would typically require the entity to evaluate whether the performance obligation is loss-making.
- BC210 The boards noted that performance obligations excluded from the scope of the onerous test (ie performance obligations satisfied at a point in time) typically have or result in the creation of related assets that would be subject to impairment testing in other standards. For example, existing standards on inventory already provide requirements on how an entity should test for impairment inventory that is subject to a sales contract. Those requirements may also require an entity to recognise any loss from contracts to transfer goods to a customer at a point in time, even if the entity has not yet acquired those goods that would be recognised as inventory (see paragraph 31 of IAS 2 *Inventories* and ASC paragraph 330-10-35-17).

Identifying when a performance obligation is onerous

- BC211 In the 2010 exposure draft, the boards proposed that an entity should identify a performance obligation as onerous when the expected costs to satisfy the performance obligation exceed the amount of the transaction price allocated to that performance obligation. The boards observed that the main consequence of using this approach is that any margin in the measurement of the performance obligation would act as a buffer to absorb adverse changes in the performance obligation. In other words, the amount of the performance obligation would remain unchanged until the entity expects that the satisfaction of the performance obligation would result in a loss.
- BC212 In developing the 2010 exposure draft, the boards considered, but rejected, requiring an entity to identify a performance obligation as onerous when the current price of the performance obligation (ie costs plus a margin) exceeds the amount of the transaction price allocated to it. The boards observed that this approach would potentially result in earlier recognition of the effects of adverse changes in circumstances because any margin in the measurement of the performance obligation would not be used as a buffer to absorb adverse changes. However, because this approach would include a margin in the trigger for identifying when a performance obligation is onerous, the boards decided that it would increase the frequency of remeasurements.

Consequently, it would increase complexity and more closely resemble an approach in which the performance obligations are remeasured at each reporting date, which is an approach that the boards had previously rejected (as discussed in paragraph BC26).

- BC213 In re-deliberations, the boards noted that in some cases, the expected costs to satisfy a performance obligation might exceed the amount that the entity would have to pay under the terms of the contract to exit the performance obligation (for example, the amount the entity would be required to pay the customer to cancel the performance obligation). In such cases, an entity rationally would select the option with the lowest cost of settling the performance obligation (ie the lower of fulfilling and exiting). Therefore, the boards revised the trigger for identifying when a performance obligation is onerous by specifying that it is onerous when the lowest cost of settling the performance obligation (which is the lower of the costs that relate directly to satisfying the performance obligation and the amount that the entity would pay to exit the performance obligation) exceeds the amount of the transaction price allocated to it.

Measurement basis

- BC214 The boards affirmed their proposal in the 2010 exposure draft that when a performance obligation is onerous, it should be remeasured on a basis that is consistent with the trigger for identifying when that performance obligation is onerous. Accordingly, they decided that an onerous performance obligation should be measured at the lowest cost of settling that obligation. Additionally, the boards affirmed the proposal in the 2010 exposure draft that the costs that relate directly to satisfying the performance obligation should be the same as those defined in paragraph 92 of the proposed requirements. In the absence of specifying a value or a price for the remeasurement, the boards decided that this approach would provide a clear objective for which costs to include.
- BC215 In developing the 2010 exposure draft, the boards considered, but rejected, requiring entities to include a margin in the remeasurement of an onerous performance obligation. The rationale for including a margin would be that a profit-oriented entity does not typically promise to transfer a good or service to a customer without a margin. However, the boards noted that including a margin in the remeasurement would be a significant change to the requirements for loss-making contracts in existing standards (for example, IAS 11 and ASC Subtopic 605-35) and

would increase the complexity of remeasuring onerous performance obligations, particularly when observable prices do not exist. Furthermore, some think that it would be counter-intuitive for an entity to recognise a profit when it satisfies an onerous performance obligation.

Presentation of the liability for onerous performance obligations

BC216 The boards decided that when an entity remeasures an onerous performance obligation, it should recognise the corresponding amount in profit or loss separately from revenue. Additionally, because the remeasurement would need to be tracked for the purposes of reporting its effects in profit or loss separately from revenue, the boards decided that it would be clearer if they specified that the remeasurement is recognised as a liability separate from the contract asset or contract liability. That would be consistent with existing standards and practices and would clarify that the remeasurement and its subsequent accounting should not affect revenue.

Contract costs (paragraphs 91–103)

Costs of fulfilling a contract (paragraphs 91–93)

BC217 In the 2010 exposure draft, the boards developed requirements for accounting for some costs to fulfil a contract. Those requirements were developed in response to concerns that the proposals in the discussion paper focused on how an entity should recognise revenue in a contract without considering how an entity should account for the costs to fulfil a contract. Some respondents to the discussion paper, in particular those from the construction industry, said that requirements on profit margin recognition are as important as requirements on revenue recognition. Other respondents, mainly preparers who use US GAAP, were concerned about the withdrawal of cost guidance that was developed specifically for their respective industries.

BC218 The proposed cost requirements in the 2010 exposure draft was intended to:

- (a) fill the gap arising from the withdrawal of existing revenue standards—the proposed revenue standard would result in the withdrawal of some requirements on contract costs, in particular, the requirements in IAS 11 and ASC Subtopic 605-35.

- (b) improve current practice—the proposed requirements would provide clearer requirements for accounting for some costs to fulfil a contract (for example, set-up costs for services) and would result in an entity no longer having to rely on, or analogue to, requirements that were not developed specifically for contracts with customers. For instance, in accounting for set-up costs, an entity applying US GAAP might analogue to the guidance on the deferral of direct loan origination costs in paragraph 310-20-25-2. An entity applying IFRSs might evaluate those costs in accordance with IAS 38 *Intangible Assets*. Specifying clear requirements would also result in greater consistency in practice.
- (c) promote convergence in accounting for contract costs—more costs would be accounted for similarly under IFRSs and US GAAP (although total consistency in accounting for costs to fulfil a contract will not be achieved until the boards align their respective standards on inventories; property, plant and equipment; intangible assets; and impairment of assets).

BC219 Most respondents supported the proposed requirements in the 2010 exposure draft. Some respondents recommended that the boards address cost requirements comprehensively in a separate project. However, because cost requirements are included in many existing standards, the boards noted that this would require reconsideration of those existing standards, such as inventories; property, plant and equipment; intangible assets; and impairment of assets. The boards decided against broadening the scope of the proposed cost requirements at this time because they thought that the proposed requirements would result in worthwhile improvements to both IFRSs and US GAAP until such time that the boards decide to comprehensively reconsider existing cost requirements.

BC220 Because the boards decided not to reconsider all cost requirements comprehensively, paragraphs 91–103 of the proposed requirements specify the accounting for contract costs that are not within the scope of other standards. Consequently, if the other standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under the proposed requirements (for example, pre-production costs under long-term supply arrangements would continue to be accounted for in accordance with ASC paragraphs 340-10-25-1 through 25-3).

BC221 The proposals clarify that only costs that give rise to resources that will be used in satisfying performance obligations in the future and that are expected to be recovered would be eligible for capitalisation. Those proposals ensure that only costs that result in assets are capitalised and an entity would be precluded from deferring costs merely to normalise profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract. To provide a clear objective for recognising and measuring an asset arising from contract fulfilment costs, the boards decided that only costs that relate directly to a contract should be included in the cost of the asset.

Incremental costs of obtaining a contract (paragraphs 94–97)

BC222 In the 2010 exposure draft, the boards proposed that an entity should recognise the costs of obtaining a contract as expenses when those costs are incurred. The boards observed that, in concept, an entity may obtain a contract asset as a result of its efforts to obtain a contract (because the measure of the remaining rights might exceed the measure of the remaining obligations). However, they decided that under the proposed model, an entity should recognise a contract asset and revenue only as a result of satisfying a performance obligation in the contract. Therefore, the 2010 exposure draft specified that the contract asset would be measured at zero at contract inception and any costs of obtaining a contract would be recognised as expenses when incurred.

BC223 Many respondents disagreed with recognising all costs to obtain a contract as expenses when incurred because they thought that the assets arising from those costs should be recognised in some cases. In addition, they noted that:

- (a) other standards require some of the costs of obtaining a contract to be included in the carrying amount of an asset on initial recognition; and
- (b) the proposals in the 2010 exposure draft were inconsistent with the tentative conclusions in the boards' Leases and Insurance Contracts projects.

- BC224 During re-deliberations, the boards decided that, in some cases, it might be misleading for an entity to recognise all the costs of obtaining a contract as expenses when incurred. For example, the boards observed that recognising the full amount of a sales commission as an expense at inception of a long-term service contract (when that sales commission is reflected in the pricing of that contract and expected to be recovered) would fail to acknowledge the existence of an asset.
- BC225 Therefore, the boards decided that an entity should recognise an asset from the costs of obtaining a contract but present the asset separately from the contract asset or liability. To limit the acquisition costs to those that can be clearly identified as relating specifically to, and recoverable under, a contract, the boards propose that only the incremental costs of obtaining a contract should be included in the measurement of the asset. The boards decided that determining whether other costs relate to a contract can be more subjective. The proposed approach is also consistent with most existing revenue recognition practices (for example, for investment management services as described in the illustrative examples that accompany IAS 18).
- BC226 The boards acknowledge that, in some cases, the costs to an entity of recognising an asset from incremental acquisition costs might exceed the financial reporting benefits. Therefore, as a practical expedient, they decided to allow an entity to recognise those costs as expenses when incurred for contracts in which the amortisation period for the asset that the entity otherwise would have recognised is one year or less.

Amortisation and impairment (paragraphs 98–103)

- BC227 The 2010 exposure draft proposed that an entity should amortise the asset recognised from fulfilment costs in accordance with the pattern of transfer of goods or services to which the asset relates. Respondents to the 2010 exposure draft generally supported that proposal but asked the boards to clarify whether those goods or services might relate to future contracts. Hence, the boards clarified in this exposure draft that in amortising the asset in accordance with the transfer of goods or services to which the asset relates, those goods or services could be provided under an anticipated contract that the entity can identify specifically. That conclusion is consistent with the notion of amortising an asset over its useful life and with existing requirements.

- BC228 The boards considered testing for impairment a recognised asset arising from fulfilment costs using one of the existing impairment tests in their respective standards (for example, IAS 2; ASC Section 330-10-35 on subsequent measurement of inventory; IAS 36 *Impairment of Assets*; and ASC Section 360-10-35 on the impairment of long-lived assets). However, the boards decided that to be consistent with the measurement approach of the proposed requirements, the impairment test should be based on comparing the carrying amount of the asset with the remaining amount of consideration to which an entity expects to be entitled in exchange for the goods or services to which the asset relates less the remaining costs of providing those goods or services—ie typically the amount of the transaction price allocated to the remaining performance obligations in the contract less the remaining costs to fulfil. That also would be consistent with the test for identifying whether performance obligations are onerous (as discussed in paragraphs BC211–BC213).
- BC229 In the light of feedback on the 2010 exposure draft, this exposure draft specifies that when the reasons for an impairment cease to exist, that impairment should not be reversed under US GAAP but should be reversed under IFRSs. The boards acknowledged that this would result in entities accounting differently for those contract costs under IFRSs and US GAAP. However, the boards decided that because the reasons for an impairment of an asset recognised in accordance with paragraph 91 or 94 could also result in impairments of other assets, it was important for the proposed requirements to be consistent with their respective impairment models for other types of assets, which have different requirements for the reversal of impairments.

Learning curve

- BC230 A learning curve is the effect of efficiencies realised over time when an entity's costs of performing a task (or producing a unit) decline in relation to how many times the entity performs that task (or produces that unit). The phenomenon of a 'learning curve' can exist independently of a contract with a customer. For example, a typical manufacturer that produces units for inventory would become more efficient in its production process over time. Some respondents to the 2010 exposure draft questioned how to apply the proposals to account for the effects of learning costs in a contract with a customer.
- BC231 The boards noted that the proposals in the 2010 exposure draft already addressed the accounting for the effects of learning costs in the following situations:

- (a) an entity has a single performance obligation to deliver a specified number of units; and
 - (b) the performance obligation is satisfied over time.
- BC232 In those situations, an entity would recognise revenue by selecting a method of measuring progress that depicts the transfer over time of the good or service to the customer. An entity likely would select a method (for example, cost-to-cost) that would result in the entity recognising more revenue and expense for the early units produced relative to the later units. That effect would be appropriate because of the greater value of the entity's performance in the early part of the contract. If an entity were to sell only one unit, it would charge the customer a higher price for that unit than the average unit price when the customer purchases more than one unit.
- BC233 In other situations, an entity may promise to deliver a specified number of units in a contract, but that promise does not give rise to a single performance obligation that is satisfied over time. In those situations, the boards decided that an entity should apply the requirements of other standards (for example, IAS 2) for the following reasons:
- (a) if an entity incurs costs to fulfil a contract but does not satisfy a performance obligation over time, then the entity would likely be creating an asset that would be in the scope of other standards. For example, the costs of producing tangible units would accumulate as inventory and the entity would select an appropriate method of measuring that inventory (for example, on the basis of average costs). In such cases, the boards decided that an entity should not account for the learning curve differently depending on whether a contract exists.
 - (b) the type of contract described in this paragraph is not the type of contract contemplated by IAS 11 and ASC Subtopic 605-35, which are the standards typically used by respondents who questioned the accounting for learning curve effects in accordance with the proposed requirements.
- BC234 The boards, however, acknowledged the diversity in practice when accounting (in accordance with other standards) for the costs of products produced under long-term production programmes. They agreed to consider adding a project to their agenda at a future time.

Presentation (paragraphs 104–108)

- BC235 The boards propose that the remaining rights and performance obligations in a contract form a single unit of account and should be accounted for, and presented, on a net basis as either a contract liability or a contract asset. The boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer is dependent on the entity’s performance and, similarly, the entity will perform only as long as the customer continues to pay. They decided that these interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.
- BC236 The boards considered whether the rights and performance obligations in contracts that are subject to the legal remedy of specific performance should be presented on a gross basis, ie as separate assets and liabilities. The boards observed that in the event of a breach, such contracts require the entity and the customer to perform as specified in the contract. Therefore, unlike most contracts that can be settled net, specific performance contracts would generally result in a two-way flow of resources between the customer and the entity. The contracts are akin to those financial contracts that are settled by physical delivery rather than by a net cash payment and for which the units of account are the individual assets and liabilities arising from the contractual rights and obligations.
- BC237 However, the boards decided against making any exception for specific performance contracts. That is because the remedy of specific performance is relatively rare and is not available in all jurisdictions. In addition, it is only one of a number of possible remedies that could be awarded by a court if legal action were taken for breach of contract. Therefore, basing the accounting on a determination of what would happen in that event would be both counter-intuitive (because entities do not enter into contracts with the expectation that they will be breached) and difficult (because an entity would need to determine at contract inception what remedy would be awarded by the court if litigation were to take place in the future).
- BC238 The boards decided that the proposed requirements should not specify whether an entity should be required to present its contract assets and contract liabilities as separate line items in the statement of financial position. Instead, an entity should apply the general principles for the presentation of financial statements to determine whether to present contract assets and contract liabilities separately in the statement of

financial position. For example, IAS 1 *Presentation of Financial Statements* requires an entity to present separately each material class of similar items and items of a dissimilar nature or function unless they are immaterial. The boards noted that in some industries, an entity typically provides additional detail about its contract assets and contract liabilities either in the financial statements or in the notes. For instance, the entity may use different labels to describe those assets or liabilities or may recognise them in more than one line item. Because that additional detail is often useful to users of those financial statements, the boards decided that an entity could use different descriptions of ‘contract assets’, ‘contract liabilities’, and ‘receivables’ and could use additional line items to present those assets and liabilities if the entity also provides sufficient information for users to be able to distinguish those assets and liabilities. The boards noted that, regardless of how an entity presents its contract assets and contract liabilities in the statement of financial position, the entity is required to disclose those contract assets and contract liabilities as part of the reconciliation in paragraph 117.

Relationship between contract assets and receivables

- BC239 When an entity performs first by satisfying a performance obligation before a customer performs by paying the consideration, the entity has a contract asset—a right to consideration from the customer in exchange for goods or services transferred to the customer.
- BC240 In many cases, that contract asset is an unconditional right to consideration—a receivable—because nothing other than the passage of time makes payment of the consideration due. The boards decided that there was no need for the revenue recognition standard to address the accounting for receivables in addition to revenue recognition. Issues such as the subsequent measurement (or impairment) of receivables and disclosures relating to those assets are already addressed in IFRSs and US GAAP.
- BC241 Therefore, the boards decided that once an entity has an unconditional right to consideration, the entity should present that right as a receivable separately from the contract asset and account for it in accordance with existing requirements. Consequently, contract assets would be recognised in accordance with the proposed requirements when an entity has satisfied a performance obligation but does not yet have an unconditional right to consideration, for example, because it first needs to satisfy another performance obligation in the contract.

BC242 In many cases, an unconditional right to consideration arises when the entity satisfies the performance obligation and invoices the customer. For example, a payment for goods or services is typically due and an invoice is issued when the entity has transferred the goods or services to the customer. However, the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration. For instance, the entity may have an unconditional right to consideration before it invoices (unbilled receivable) if there is nothing but the passage of time before it is able to issue an invoice. In addition, in some cases, an entity can have an unconditional right to consideration before it has satisfied a performance obligation. For example, an entity may enter into a non-cancellable contract that requires the customer to pay the consideration a month before the entity provides goods or services. On the date when payment is due, the entity has an unconditional right to consideration. (However, in such cases, the entity would recognise revenue only when it has transferred the goods or services.)

Disclosure (paragraphs 109–129)

BC243 Some of the main criticisms made by regulators and users of existing revenue requirements are that the disclosures are inadequate and lack cohesion with the disclosure of other items in the financial statements. For example, many users complain that entities present revenue in isolation so that users cannot relate revenue to the entity's financial position.

BC244 In the light of those deficiencies, the boards decided to propose a comprehensive and coherent set of disclosures to help users of financial statements understand and analyse how contracts with customers affect an entity's financial statements. The boards decided that a comprehensive and coherent set of revenue disclosures should include the following:

- (a) an explanation of the composition of revenue recognised in a reporting period;
- (b) a reconciliation of changes in contract asset and liability balances from period to period;
- (c) information about performance obligations and onerous contracts that the entity has with customers;
- (d) information about acquisition and fulfilment costs; and

- (e) an explanation of the judgements, and changes in the judgements, used in recognising revenue.

BC245 The boards' conclusions on the disclosure of this type of information are explained in paragraphs BC249–BC271.

Disclosure objective (paragraphs 109–112)

BC246 Many recent standards specify a disclosure objective. The boards decided that the proposed requirements should also specify an objective for the revenue disclosures. In the boards' view, interpretation and application of the disclosure requirements improve if the overarching objective of the disclosures is clearly stated. That is because a preparer can assess whether the overall quality and informational value of its revenue disclosures are sufficient to meet users' needs. The boards also observed that specifying a disclosure objective would avoid the need for detailed and prescriptive disclosure requirements to meet the specific information needs for the many and varied types of contracts with customers that are within the scope of the proposed requirements. The boards noted that developing principle-based disclosure requirements is necessary because it would not be possible or appropriate, given the objective of a single revenue standard, to develop specific requirements for specific transactions or industries.

Materiality

BC247 Most respondents to the 2010 exposure draft (mainly preparers, auditors and some professional bodies and national standard-setters) stated that when viewed as a package, the disclosures specified in the 2010 exposure draft would result in voluminous disclosures that may not be justified on a cost-benefit basis. In contrast, users of financial statements generally supported the disclosure package because they consider existing revenue disclosures to be insufficient. That conflicting feedback on the proposed disclosures highlights the challenges that the boards have faced in developing disclosures that provide users with information that is useful and that can be prepared at a reasonable cost.

BC248 After consulting further with some users and preparers, the boards decided that the revised proposed disclosures achieve an appropriate balance between users' needs and preparation concerns. The boards disagreed with concerns that the proposed disclosures are excessive. Although the volume of disclosure would increase compared to existing revenue disclosure requirements, the boards consider that the increase in disclosure is necessary for an improvement to existing disclosure

practices and the usefulness of financial reporting, which, as noted in paragraph BC243, have substantial shortcomings. Furthermore, the boards think that at least some of the concerns about excessive disclosure are based on inferences relating to the length of the list of proposed disclosures. That list of disclosures is necessary because the revenue standard would apply to entities operating in a wide array of industries and, as such, needs to specify revenue disclosures that might be relevant for some entities or industries but not for others. Consequently, those disclosures should not be viewed as a checklist of minimum disclosures. One of the reasons the boards included paragraph 110 in the proposed requirements is to clarify that, consistently with existing requirements in IFRSs and US GAAP on materiality, an entity would not need to disclose information that is immaterial. For the purposes of applying the disclosure requirements, the boards noted that an entity should consider materiality in determining how much information to provide.

Disaggregation of revenue (paragraphs 114–116)

- BC249 Revenue recognised in the statement of comprehensive income is a composite amount arising from many contracts with customers. The revenue could arise from the transfer of different goods or services or from contracts involving different types of customers or markets. The disclosure of disaggregated revenue information helps users to understand the composition of the revenue that has been recognised in a reporting period. The level of disaggregation is important because information is obscured if the disclosure of that information is either too aggregated or too granular.
- BC250 In developing the 2010 exposure draft, the boards observed that existing standards require revenue to be disaggregated and that those standards specify the basis for the disaggregation. For example:
- (a) IAS 18 requires disclosure of the amount of each significant category of revenue recognised during the period, including revenue arising from the sale of goods, the rendering of services, interest, royalties and dividends.
 - (b) IFRS 8 *Operating Segments* and ASC Topic 280 on segment reporting require an entity to disclose revenue for each operating segment (reconciled to total revenue) and to disaggregate its total revenue by products or services (or by groups of similar products or services) and by geographical areas to the extent that the entity's operating segments are not based on different products or services or different geographical areas. Related disclosure is required on the

entity's types of products and services and its major customers. However, the amounts disclosed can be measured on a basis that is used internally and might not agree with the measurements used in IFRSs or US GAAP.

- BC251 Feedback from users consulted on the revenue disclosures indicated that the basis for meaningfully disaggregating revenue should not be uniform. Because the most useful disaggregation of revenue depends on various entity-specific or industry-specific factors, the boards decided that the proposed requirements should not prescribe a specific characteristic of revenue to be used as the basis for disaggregation. Instead, the boards decided that an entity should disaggregate revenue into the primary categories that best depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. In re-deliberating the proposed disclosures, the boards clarified that an entity may need to use more than one type of category to disaggregate revenue to meet that disclosure objective.
- BC252 The boards clarified that the allowance for any impairment loss that is presented adjacent to revenue (in accordance with paragraph 69) is not required to be disaggregated in accordance with paragraph 114. The boards noted that disaggregation of the impairment loss could be difficult to prepare and may provide only limited useful information. That is because credit risk is a customer-specific risk that is typically managed by the entity centrally, whereas the most useful disaggregation of revenue will typically be specific to the attributes of the transaction (for example, by type of good or service or geography).
- BC253 Some respondents to the 2010 exposure draft were concerned that the proposal to disclose revenue on a disaggregated basis would duplicate the disaggregation requirements for revenue in IFRS 8 and ASC Topic 280. Paragraph 112 of this exposure draft clarifies that an entity would not need to disclose information if it has provided the information in accordance with another standard. Consequently, an entity would not need to provide disaggregated revenue disclosures if the entity is separately providing segment reporting disclosures for revenue that would meet the requirements specified in paragraph 114 and those disclosures recognise and measure revenue in accordance with the proposed requirements. Nevertheless, the boards included a proposal to disaggregate revenue in the proposed requirements for the following reasons:

- (a) the segment reporting disclosures for revenue may be based on non-GAAP information (ie the revenue that is reported to the chief operating decision maker may be recognised and measured on a basis that is not in accordance with the revenue standard); and
- (b) some entities that would apply the revenue standard are exempt from providing segment disclosures (for example, entities that are not listed on a public stock exchange).

Reconciliation of contract balances (paragraph 117)

BC254 For users to assess the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers, they need to understand the relationship between the revenue recognised in a reporting period and changes in the balances of the entity's contract assets and contract liabilities. Among other things, this includes identifying whether the entity typically receives payment before or after transferring goods or services to the customer and quantifying the relationship between revenue recognised and cash flows. Although entities currently recognise working capital balances at each reporting date, such as trade receivables and deferred revenue, users have indicated that the relationship between those balances and the revenue recognised in the period is unclear. Therefore, to clarify that relationship, the boards proposed in the 2010 exposure draft that an entity should disclose a reconciliation of the contract asset and contract liability balances.

BC255 In developing the 2010 exposure draft, the boards considered whether the reconciliation of contract balances should be presented gross or net. A gross reconciliation would show the remaining contractual rights and performance obligations in separate columns with a total net amount that links to the statement of financial position. In doing so, the reconciliation would highlight the amount of new contracts obtained and the amount of unsatisfied performance obligations and, hence, indicate the amount of revenue expected to be recognised in the future as a result of contracts that already exist. The boards acknowledged that this information would be useful to users of financial statements. However, they also noted the following:

- (a) the cost of preparing and auditing the reconciliation would be high because an entity would be required to measure all unperformed contracts, including executory contracts;
- (b) there is a high level of judgement inherent in executory contracts, including determining when a contract comes into existence; and

- (c) the information provided may not be useful for many types of contracts, such as those with a short duration.

Hence, the boards decided to propose in the 2010 exposure draft that an entity should disclose a reconciliation from the opening to the closing balance of the contract assets and contract liabilities recognised in the statement of financial position.

- BC256 Preparers and users expressed differing views on the proposal to disclose a reconciliation of contract balances. Most preparers commented that it would be costly to compile and present the information required by the reconciliation of contract assets and contract liabilities. Furthermore, some preparers doubted whether, given the preparation costs, the disclosure would be cost-beneficial. In contrast, users stated that the information that would be provided by the reconciliation is not available from other qualitative or quantitative disclosure requirements. And, although the reconciliation would impose costs on preparers, those users commented that the disclosure was important because it would help them to understand the interaction between revenue that has been recognised and the movements in cash and receivables, as well as to understand contract assets and contract liabilities.
- BC257 In the light of the feedback received from some preparers, the boards considered whether to require an entity to disclose the reconciliation only if specified criteria are met. For instance, those criteria might include the following:
- (a) the contract meets specified attributes (for example, it is a long-term contract or the entity operates in a particular industry); and
 - (b) the contract assets or contract liabilities are classified as non-current assets or liabilities in the statement of financial position.
- BC258 The boards decided that this would not be a viable approach because of the difficulty in clearly identifying those types of contracts or industries for which a reconciliation would provide (or would not provide) useful information. Even though users suggested that the reconciliation would be especially useful for industries or entities with long-term contracts, such as construction contracts and outsourcing contracts, they also indicated that there would be other circumstances in which a reconciliation of contract balances would be useful. Furthermore, the criteria in paragraph BC257 could result in excluding some of an entity's contract assets and contract liabilities from the reconciliation. If that were to happen, the disclosure would not represent a reconciliation of the items in the financial statements.

- BC259 Therefore, the boards affirmed the proposal to require the reconciliation of contract balances because of the importance of that information to users of financial statements. The boards also decided that the reconciliation should be presented in a tabular format because users commented that this would make the reconciliation easier to understand and would facilitate comparisons between entities.
- BC260 The boards observed that an entity should consider whether the information to be disclosed in the reconciliation would be material. As explained in paragraph BC248, the boards think that the requirements in existing IFRSs and US GAAP not to disclose immaterial information would apply in determining:
- (a) when the reconciliation is provided (for example, the reconciliation could be immaterial for entities that operate cash sales businesses); and
 - (b) how much detail is provided in that reconciliation (ie how many reconciling items are presented).

Disclosure of remaining performance obligations (paragraphs 119–121)

- BC261 In the 2010 exposure draft, the boards proposed that an entity should disclose the amount of its remaining performance obligations and the expected timing of the satisfaction of those performance obligations (in one-year time bands for each of the subsequent three years and a fourth time band for all performance obligations remaining after three years). That was because the reconciliation of contract balances would not result in the disclosure of information about an entity's performance obligations on a gross basis. The boards determined that separately disclosing the remaining performance obligations would enable users to:
- (a) assess the risks associated with future revenues. In general, users see the outcome as more uncertain if satisfaction of the performance obligation occurs at a much later date because it will be subject to a greater number of factors and uncertainties than will a more immediately satisfied performance obligation.
 - (b) understand the timing and amount of revenue to be recognised from existing contracts.
 - (c) analyse trends in the amount and timing of revenue.

- (d) obtain consistency in the reporting of 'backlog', which often is disclosed by entities in management commentary but calculated on a variety of bases.
- (e) understand how changes in judgements or circumstances might affect the pattern of revenue recognition.

Because the information provided by this disclosure would be most useful for longer term contracts, the boards proposed the disclosure for only those contracts with an original expected duration of more than one year.

BC262 Many respondents to the 2010 exposure draft questioned whether the proposal would be cost-beneficial. Users commented that the proposed disclosure could have some information value for some types of contracts (for example, the disclosure would provide more useful information for subscription services than for retail transactions). However, they suggested that the usefulness of the disclosure would be enhanced significantly if the disclosure also included the remaining performance obligations associated with wholly unperformed contracts that could be terminated without penalty. Other respondents, including preparers, made the following observations:

- (a) the disclosure would be difficult and costly to prepare and audit because existing accounting systems are not designed to track and capture the required information, including the information on scheduling the timing of the satisfaction of those remaining performance obligations;
- (b) the information provided by the disclosure could be misinterpreted because, depending on the nature of the entity's business(es), the disclosure may give prominence to only a relatively small subset of the entity's potential future revenues; and
- (c) forward-looking information should be presented in management commentary rather than in the notes to the financial statements, especially because the location of that disclosure also has practical consequences in some jurisdictions. For instance, in the United States, disclosures that are presented in the notes to the financial statements are excluded from the 'safe harbour' protections regarding forward-looking statements that are afforded under the Private Securities Litigation Reform Act and the Securities and Exchange Commission's related regulations.

- BC263 In re-deliberating the proposed disclosure of remaining performance obligations, the boards observed that the circumstances that led them to propose the disclosure remained unchanged because they had affirmed their proposal to require a reconciliation of contract balances to be provided on a net basis rather than on a gross basis. The boards also observed that in some industries in which long-term contracts are essential to the business model, disclosure of a similar (but non-GAAP) nature is demanded by analysts as a critical input to the evaluation of revenue and revenue growth. However, because of the concerns raised by users and preparers about the proposed disclosure, the boards considered the disclosure of different amounts of future revenues from contracts with customers and whether those amounts provide users of financial statements with useful information.
- BC264 The boards decided to retain the proposal in the 2010 exposure draft (ie the disclosure of future revenue from contracts with customers should be the gross amount of performance obligations remaining from contracts with an original expected duration of more than one year). The boards decided against requiring the disclosure of future revenue from contracts with customers based on the other amounts for the following reasons:

Measure	Reason for rejection
<p>Disclosure of the carrying amount of contract liabilities (ie scheduling when advance payments received from customers will be recognised as revenue).</p>	<p>The boards decided that the proposal in the 2010 exposure draft would provide users with more relevant information (for example, for the purposes outlined in paragraph BC261).</p> <p>The boards noted that some entities currently disclose a maturity analysis of their contract liabilities that will be recognised as revenue in future reporting periods (particularly entities that provide subscription or information technology support services over time, for which customers typically pay in advance). The boards think that those entities would continue to provide that information if users demand it.</p> <p style="text-align: right;"><i>continued...</i></p>

<i>...continued</i> Measure	Reason for rejection
Disclosure of the gross amount of performance obligations remaining from all contracts with customers (ie including those contracts with an original expected duration of one year or less).	The boards rejected this alternative on a cost-benefit basis. They think that the cost of preparing the disclosure for short-term contracts would not be offset by the benefits provided by that disclosure.
Disclosure of order book/backlog, including cancellable contracts or the disclosure of estimated future revenue of the entity including anticipated contracts.	Although the disclosure of this information was supported by users, the boards rejected this disclosure because it would have included revenue that is outside the scope of the proposed requirements (ie the disclosure would include future contracts and contracts that are wholly unperformed and that can be terminated without penalty).

BC265 Nevertheless, the boards acknowledged that the proposed disclosure would impose significant costs on preparers and, therefore, the boards considered whether the disclosure could be limited to those contracts whereby the information on remaining performance obligations would be most cost-beneficial to disclose. The boards decided to:

- (a) affirm the proposal in the 2010 exposure draft to exclude from the disclosure those contracts that have an original expected duration of one year or less; and
- (b) propose that, as a practical expedient, an entity need not disclose the amount of remaining performance obligations if the nature of the contract is such that the entity recognises revenue as invoiced. The boards proposed this practical expedient after observing that, in some cases, an entity would not need to strictly apply each step of the model to be able to recognise revenue. This would be the case for some 'cost plus' or 'time and materials' contracts in which the contract price is based on a rate per unit of input (for example, hours worked and materials consumed). With those contracts, an entity would be able to recognise revenue as it performs the work and consumes the materials in the amount specified in the contract without needing to apply each step of the revenue model.

By permitting those contracts to be excluded from the scope of the proposed disclosure, the boards are ensuring that an entity would not be required to determine the transaction price and allocate that amount to the performance obligations in the contract for the purposes of preparing the disclosure.

BC266 Many respondents also disagreed with the proposal in the 2010 exposure draft that prescribed the basis for presenting the maturity analysis (ie by requiring the remaining performance obligations to be scheduled into one-year time bands). Respondents disagreed with the rigidity of those time bands and some also expressed a concern that the scheduling could imply a false degree of precision in the expectation of when a performance obligation will be satisfied. Hence, the boards decided to permit an entity to choose whether to provide that explanation:

- (a) on a quantitative basis using a time band series that would be most appropriate for the duration of the contract; or
- (b) by using a mixture of quantitative and qualitative information in scheduling the amount of remaining performance obligations.

Performance obligations (paragraph 118)

BC267 Existing standards require entities to disclose their accounting policies for recognising revenue (see paragraph 10(e) of IAS 1 or the requirements in ASC Section 235-10-50 on disclosure in the notes to financial statements). However, users have suggested that in many cases, entities provide a 'boilerplate' description of the accounting policy adopted without explaining how the accounting policy relates to the contracts that the entity enters into with customers. To address that problem, paragraph 118 of this exposure draft would require an entity to disclose information about its performance obligations in contracts with customers. That proposed disclosure would complement the accounting policy disclosure requirements in existing standards by requiring an entity to provide more descriptive information about its performance obligations.

Onerous performance obligations (paragraphs 122 and 123)

BC268 The boards decided that the disclosures relating to onerous performance obligations recognised in accordance with the proposed requirements should be consistent with the existing onerous contract disclosures in IAS 37.

Assumptions and uncertainties (paragraphs 124–127)

- BC269 IFRSs and US GAAP have general requirements for the disclosure of significant accounting estimates and judgements made by an entity. Because of the importance placed on revenue by users of financial statements, the boards decided to propose specific disclosure requirements on the estimates used and judgements made in determining the amount and timing of revenue recognition.
- BC270 The FASB's Emerging Issues Task Force (EITF) reached a similar conclusion when developing the guidance in ASC Section 605-25-50 for the disclosure of multiple-element arrangements. The EITF consulted extensively to develop disclosures to communicate the judgements used and their effect on the recognition of revenue from multiple-element arrangements. After considering whether those disclosures could apply appropriately to all contracts with customers, the boards decided that the proposed requirements should include disclosures on significant judgements that are similar to those required by ASC Section 605-25-50.

Assets from the costs to obtain or fulfil a contract (paragraphs 128 and 129)

- BC271 Users commented that the 2010 exposure draft did not propose any disclosures about assets arising from costs to fulfil a contract. They thought that information about these assets would be helpful in understanding the types of costs that the entity has recognised as assets and how those costs are subsequently amortised or impaired. Consequently, the boards decided that an entity should disclose a reconciliation of the carrying amount of an asset arising from the costs to obtain or fulfil a contract with a customer, by major classification at the beginning and end of the period. The boards also decided that this disclosure was necessary to replace some of the existing disclosures that would be eliminated by consequential amendments to IAS 2 and ASC Topic 605 on revenue recognition.

Disclosures required for interim financial reports

- BC272 In the absence of specific disclosure requirements for interim financial reports, an entity would apply IAS 34 *Interim Financial Reporting* or Topic 270 on interim reporting to determine the information about revenue from contracts with customers that the entity should disclose in its interim financial reports. Those standards require, as a general principle, that an entity disclose information about significant changes in financial

position and performance of the entity since the end of the last annual reporting period. However, because information about revenue is crucial for users of financial statements to make informed assessments about an entity's financial performance and prospects, the boards decided to specify the disclosures about revenue and contracts with customers that an entity should provide in interim financial reports. Hence, users would be provided with consistent and comparable disclosures in interim periods because specifying the required disclosures would limit the risk that entities could reach different conclusions on what represents a significant change and how information about that significant change should be presented in the interim financial reports.

BC273 The disclosures specified by the boards relate to information that would be expected to change significantly from period to period; therefore disclosure of that information would be consistent with the general disclosure principles in IAS 34 and Topic 270. The boards considered, but ultimately rejected, an alternative approach of specifying that an entity should disclose a disaggregation of revenue in interim financial reports and to specify other disclosures that an entity might need to disclose only if that information significantly changes from period to period. Although in some cases that alternative approach could limit the volume of information that would be required to be disclosed in interim financial reports, the boards decided that the alternative might result in diversity in the amount of information that some entities disclose in interim financial periods given the judgement associated with identifying what represents a significant change to the recognition of revenue.

Application guidance (paragraphs B1–B58)

BC274 The boards decided to include application guidance to clarify how the principles in the proposed requirements would apply to features found in various typical contracts with customers. Some of that application guidance is based on existing requirements in IFRSs or US GAAP. Consistently with the objective of developing a single revenue recognition model (as discussed in paragraphs BC3 and BC4), the boards do not intend to provide guidance that would apply only to specific industries.

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

- BC275 In some contracts, an entity transfers a good to a customer and also grants the customer the right to return the good to the entity. The boards decided that, conceptually, a contract with a right of return includes at least two performance obligations—a performance obligation to provide the good to the customer and a performance obligation for the return right service, which is a stand-ready obligation to accept the goods returned by the customer during the return period.
- BC276 In relation to performance obligations to provide goods to customers, the boards decided that in effect an entity has made an uncertain number of sales. That is because it is only after the return right expires that the entity will know with certainty how many sales it has made (ie how many sales did not fail). Therefore, the boards decided that an entity should not recognise revenue for the sales that are expected to fail as a result of customers exercising their return rights. Instead, for those sales, the entity should recognise a liability for its obligation to refund amounts to customers.
- BC277 The boards decided that in determining the amount of revenue to recognise (and hence the amount of the refund obligation), an entity should use the principles for recognising and measuring variable consideration. Consistently with those principles, if an entity is not reasonably assured of the amount of consideration to which it will be entitled (considering the quantity of goods to be returned), the entity would recognise any consideration received as a refund liability.
- BC278 The boards considered whether to account for the return right service as a performance obligation separate from the refund liability. If an entity does not recognise a performance obligation for the return right service, it would have recognised all of the revenue and margin in the contract once the customer obtains control of the good. Such an outcome might not faithfully depict the entity's performance under the contract. However, the boards noted that accounting for the return right service as a performance obligation that is separate from the refund liability would typically require the entity to estimate the stand-alone selling price of that service. Given that in many cases, the number of returns is expected to be a small percentage of the total sales and the return period is often short (such as 30 days), the boards decided that the incremental

information provided to users by accounting for the return right service as a separate performance obligation would not justify the complexities and costs of doing so. Therefore, the boards decided that the return right service should not be accounted for as a separate performance obligation.

- BC279 A right of return gives the entity a contractual right to recover the good from the customer if the customer exercises its option to return the good and obtain a refund. The boards decided that the right to recover the good should be recognised as an asset rather than offset against the refund liability. The boards observed that recognising the asset separately from the refund liability provides greater transparency and ensures that the asset is considered for impairment testing.

Product warranties and product liabilities (paragraphs B10–B15)

- BC280 When an entity sells a product (whether that product is a good or service) to a customer, the entity may also provide the customer with a warranty on that product. The warranty might be described as, for example, a manufacturer's warranty, a standard warranty or an extended warranty. The boards decided to provide specific guidance on applying the revenue model to warranties because many contracts with customers for the sale of products include a warranty and the nature of that warranty may vary across products, entities and jurisdictions.
- BC281 In the discussion paper, the boards proposed accounting for all warranties consistently because a unifying feature of all warranties is that an entity promises to stand ready to replace or repair the product in accordance with the terms and conditions of the warranty. The discussion paper proposed that a promise to stand ready provides the customer with a service of warranty coverage, which would be a separate performance obligation to which revenue would be attributed. However, most respondents to the discussion paper stated that the accounting for warranties should reflect the fact that some product warranties are different from others. Some warranties protect the customer from defects that exist when the product is transferred to the customer, and other warranties protect the customer from faults that arise after the product has been transferred to the customer. Those respondents commented that the customer is not receiving a separate service if the warranty only protects the customer from the product being defective at the time of sale. Consequently, any subsequent repairs or replacements are additional costs of providing the product and, therefore, relate to an entity's past performance.

- BC282 The 2010 exposure draft proposed that an entity should distinguish between warranties on the basis of the objective of the warranty (ie the nature of the protection promised to the customer). The 2010 exposure draft identified the following types of warranties:
- (a) a ‘quality assurance warranty’—a promise that the product is free from defects at the time of sale; and
 - (b) an ‘insurance warranty’—a promise to repair or replace the product if a fault arises within a specified period (normally subject to some conditions).
- BC283 The 2010 exposure draft would have required an entity to account for some warranties differently from other warranties. However, in this exposure draft, the boards decided not to distinguish between warranties only on the basis of the nature of the protection promised to the customer. They made this decision because almost all respondents to the 2010 exposure draft commented that it could be difficult to determine *when* a fault has arisen in a product. For example:
- (a) in the manufacturing industry, products often go through rigorous inspection processes before delivery to the customer and an entity may not be aware of faults at the time of delivery; or
 - (b) in the software industry, it is not clear how an entity would determine whether a software bug fix is repairing a latent defect or a defect that occurred after the product was transferred to the customer.
- BC284 Instead, paragraphs B10–B13 of this exposure draft would require an entity to identify a promised warranty as a separate performance obligation if either of the following criteria is met:
- (a) the customer has the option to purchase the warranty separately from the entity; or
 - (b) the warranty provides a service to the customer in addition to the assurance that the entity’s past performance was as specified in the contract.
- BC285 A promised warranty that does not meet the criteria in those paragraphs is not a performance obligation. In effect, those criteria provide a different basis for distinguishing between an insurance warranty (which is a separate performance obligation and is described in this exposure draft as a ‘service-type warranty’) and a quality assurance warranty (which is not a performance obligation and is described in this exposure draft as an ‘assurance-type warranty’).

Warranties that are separate performance obligations (service-type warranties)

- BC286 For some types of warranties, the entity either sells separately or negotiates separately with the customer so that the customer can choose whether to purchase the warranty coverage. That fact provides objective evidence that the promised warranty provides a service to the customer in addition to the promised product. Consequently, the boards decided that the promised warranty would be a separate performance obligation in accordance with paragraphs 28 and 29.
- BC287 For warranties that are not sold separately by the entity or negotiated separately with the customer, the boards decided that those promised warranties should also be identified as separate performance obligations if the facts and circumstances suggest that the warranty (or a part of the warranty) provides a service to the customer in addition to the assurance that the entity's past performance was as specified in the contract. The boards noted that this decision would:
- (a) provide a clear principle that allows an entity to account for economically similar warranties in a similar manner, regardless of whether the warranties are separately priced or negotiated;
 - (b) be consistent with the general principles for identifying separate performance obligations; and
 - (c) remove the bright line in existing US GAAP that distinguishes between different types of warranties based solely on whether the warranty is separately priced.
- BC288 A warranty that meets the criteria in paragraphs B10–B15 also meets the definition of an insurance contract. However, in their insurance contracts project, the boards have tentatively decided that warranties issued directly by a manufacturer, dealer or retailer should be within the scope of the revenue standard. Warranties issued by third parties are within the scope of the insurance contracts project.

Warranties that are not performance obligations (assurance-type warranties)

- BC289 The boards considered whether an assurance-type warranty should be accounted for as either of the following:
- (a) a separate liability to replace or repair a defective product; or
 - (b) an unsatisfied performance obligation because the entity has not provided the customer with a product that is free from defects at the time of sale.

BC290 The proposals in the 2010 exposure draft would have required an entity that provides an assurance-type warranty to a customer to evaluate whether it has satisfied its performance obligation to transfer the product specified in the contract. The entity would determine the likelihood and the extent of defective products that it has sold to customers and, as a consequence, not recognise revenue to the extent that those performance obligations were not satisfied. An advantage of that proposal is that an entity would not recognise the entire transaction price as revenue when the product has transferred to the customer because a portion of the transaction price would not be recognised as revenue until the entity has repaired or replaced the products that are expected to be defective. However, the boards decided not to retain that proposal in this exposure draft, mainly for the following practical reasons:

- (a) there are complexities associated with an entity being required to continue to recognise as 'inventory' those products that have been delivered to customers and that are expected to be defective; and
- (b) although an entity would recognise the entire margin for the product when it is transferred to the customer, any margin attributable to the repair or replacement of that product in an assurance-type warranty would be unlikely to significantly distort the pattern of recognition of the overall contract margin.

BC291 Accordingly, the boards decided that an entity should recognise assurance-type warranties as a separate liability to replace or repair a defective product. This exposure draft would require an entity to recognise a warranty liability and corresponding expense when it transfers the product to the customer and the liability would be measured in accordance with IAS 37 or ASC Topic 450 on contingencies. In contrast to the accounting for service warranties, an entity would not attribute any transaction price (and therefore revenue) to an assurance-type warranty. Some warranties may include both assurance features and service features. If an entity cannot reasonably account for those assurance features of the warranty separately from the service features, the boards decided that an entity should be allowed to account for the warranties together as a single performance obligation. That accounting would ensure that the entity does not overstate the recognition of revenue at the time the product transfers to the customer and also relieves the entity from identifying and accounting separately for the two components of the warranty coverage.

Statutory warranties

BC292 In some jurisdictions, the law requires an entity to provide warranties with the sale of its products. The law might state that an entity is required to repair or replace products that develop faults within a specified period from the time of sale. Consequently, these statutory warranties may appear to be service-type warranties because they would cover faults arising after the time of sale, not just defects existing at the time of sale. However, the boards decided that the law can be viewed as simply operationalising an assurance-type warranty. In other words, the objective of these statutory warranties is to protect the customer against the risk of purchasing a defective product. But rather than requiring the entity to determine whether the product was defective at the time of sale, the law presumes that if a fault arises within a specified period (which can vary depending on the nature of the product), the product was defective at the time of sale. Therefore, these statutory warranties should be accounted for as assurance warranties.

Product liability laws

BC293 The boards clarified that product liability laws do not give rise to performance obligations. These laws typically require an entity to pay compensation if one of its products causes harm or damage. The boards noted that an entity should not recognise a performance obligation arising from these laws because the performance obligation in a contract is to transfer the product to the customer. To the extent that the product is defective, the entity would recognise a liability for the expected costs to repair or replace the product (as discussed in paragraph B15). Any obligation of the entity to pay compensation for the damage or harm that its product causes is separate from the performance obligation. The boards noted that an entity would account for this obligation separately from the contract with the customer and in accordance with the requirements on loss contingencies in IAS 37 or ASC Subtopic 450-20.

**Principal versus agent considerations
(paragraphs B16–B19)**

BC294 Existing standards require an entity to assess whether it is acting as a principal or an agent when goods or services are transferred to end customers. That assessment determines whether an entity recognises revenue for the gross amount of customer consideration (if the entity is a principal) or for a net amount after the principal is compensated for its goods or services (if the entity is an agent). Under the proposed

requirements, principals and agents would have different performance obligations. A principal controls the goods or services before they are transferred to customers. Consequently, the principal's performance obligation would be to transfer those goods or services to the customer. In contrast, an agent does not control the goods or services before they are transferred to customers. The agent facilitates the sale of goods or services between a principal and the customer. Therefore, an agent's performance obligation would be to arrange for another party to provide the goods or services to the customer. The transaction price attributable to an agent's performance obligation would be the fee or commission that the agent receives for providing those services.

- BC295 It may not always be readily apparent whether an entity has obtained control of goods or services before they are transferred to a customer. Similar issues arise in consignment sales. For that reason, the boards have included in the proposed application guidance some indicators that a performance obligation relates to an agency relationship. They are based on the indicators specified in the illustrative examples that accompany IAS 18 and in the guidance on principal-agent considerations in ASC Subtopic 605-45.

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

- BC296 In some contracts, customers are given an option to purchase additional goods or services. In developing the proposed requirements, the boards considered when those options should be accounted for as a separate performance obligation. During those discussions, the boards observed that it can be difficult to distinguish between the following:
- (a) an option that the customer pays for (often implicitly) as part of an existing contract, which would be a performance obligation to which part of the transaction price is allocated; and
 - (b) a marketing or promotional offer that the customer did not pay for and, although made at the time of entering into a contract, is not part of the contract, and which would not be a performance obligation in that contract.
- BC297 Similar difficulties in distinguishing between an option and an offer have arisen in US GAAP for the software industry. In response to those practice issues, ASC Section 985-605-15 on scope and scope exceptions for software indicates that an offer of a discount on future purchases of goods or services would be presumed to be a separate option in the

contract if that discount is significant and is incremental both to the range of discounts reflected in the pricing of other elements in that contract and to the range of discounts typically given in comparable transactions. The existing notions of significant and incremental form the basis for the principle of a material right that is used to differentiate between an option and a marketing or promotional offer. However, the boards observed that even if the offered discount is not incremental to other discounts in the contract, in some cases, it could nonetheless give rise to a material right to the customer. Therefore, the boards decided not to carry forward that part of the guidance in ASC Section 985-605-15 into the exposure draft.

Allocating the transaction price

- BC298 In accordance with the proposed requirements, an entity would be required to determine the stand-alone selling price of the option so that part of the transaction price is allocated to the performance obligation. In some cases, the stand-alone selling price of the option may be directly observable or it may be indirectly observable by, for example, comparing the observable prices for the goods or services with and without the option. In many cases, though, the stand-alone selling price of the option would need to be estimated.
- BC299 Option pricing models can be used to estimate the stand-alone selling price of an option. The price of an option includes the intrinsic value of the option (ie the value of the option if it were exercised today) and its time value (ie the value of the option that depends on the time until the expiry and the volatility of the price of the underlying goods or services). The boards decided that the benefits to users of allocating some of the transaction price to the price and availability guarantees inherent in the time value component of the option price would not justify the costs and difficulties to do so. However, the boards decided that an entity should be able to readily obtain the inputs necessary to measure the intrinsic value of the option in accordance with paragraph B23 and that those calculations should be relatively straightforward and intuitive. This measurement approach is consistent with the measurement application guidance for customer loyalty points in IFRIC 13 *Customer Loyalty Programmes*.

Renewal options

- BC300 A renewal option gives a customer the right to acquire additional goods or services of the same type as those supplied under an existing contract. This type of option could be described as a renewal option within a relatively short contract (for example, a one-year contract with an option to renew that contract for a further year at the end of the first and second years) or a cancellation option within a longer contract (for example, a three-year contract that allows the customer to discontinue the contract at the end of each year). A renewal option could be viewed similarly to other options to provide additional goods or services. In other words, the renewal option could be a separate performance obligation in the contract if it provides the customer with a material right that it could not otherwise obtain without entering into that contract.
- BC301 However, in cases in which a renewal option provides the customer with a material right, there typically are a series of options. In other words, to exercise any option in the contract, the customer must have exercised all the previous options in the contract. The boards decided that determining the stand-alone selling price of a series of options would be complex. That is because determining the estimated stand-alone selling prices of the options would require an entity to identify various inputs, such as the stand-alone selling prices for the goods or services for each renewal period and the likelihood that customers will renew for the subsequent period. In other words, the entity would have to consider the entire potential term of the contract to determine the amount of the transaction price from the initial period that should be deferred until later periods.
- BC302 For that reason, the boards decided to provide an entity with a practical alternative to estimating the stand-alone selling price of the option. The practical alternative would require an entity to include the optional goods or services that it expects to provide (and corresponding expected customer consideration) in the initial measurement of the transaction price. In the boards' view, it would be simpler for the entity to view a contract with renewal options as a contract for its expected term (ie including the expected renewal periods) rather than as a contract with a series of options.
- BC303 The boards developed two criteria to distinguish renewal options from other options to acquire additional goods or services. First, the additional goods or services underlying the renewal options must be similar to those provided under the initial contract—ie the entity continues to provide what it was already providing. Therefore, it is more intuitive to view the

goods or services underlying such options as part of the initial contract. In contrast, customer loyalty points and many discount vouchers would be considered to be separate deliverables in the contract because the underlying goods or services may be of a different nature.

- BC304 The second criterion is that the additional goods or services in the subsequent contracts must be provided in accordance with the terms of the original contract. Consequently, the entity's position is constrained because it cannot change those terms and conditions and, in particular, it cannot change the pricing of the additional goods or services beyond the parameters specified in the original contract. That is different from examples such as customer loyalty points and discount vouchers. For example, if an airline frequent flyer programme offers 'free' flights to customers, the airline is not constrained because it can subsequently determine the number of points that are required to be redeemed for any particular 'free' flight. Similarly, when an entity grants discount vouchers, typically it has not constrained itself with respect to the price of the subsequent goods or services against which the discount vouchers will be redeemed.

Customers' unexercised rights (breakage) (paragraphs B25–B28)

- BC305 Some respondents to the 2010 exposure draft requested that the boards provide guidance on how to account for a customer's non-refundable prepayment for the right to receive goods or services in the future. Common examples include the purchase of gift cards and non-refundable tickets.
- BC306 The boards noted that the guidance on the allocation of the transaction price to customer options in the 2010 exposure draft implicitly explained how to account for situations in which the customer does not exercise all of its contractual rights to those goods or services (ie breakage). However, the 2010 exposure draft did not explain how to account for breakage in situations in which there is only one performance obligation in the contract (ie there is no allocation and, hence, no need to determine a stand-alone selling price).
- BC307 Consequently, the boards included application guidance in this exposure draft on the accounting for breakage (paragraphs B25–B28). That guidance is consistent with the principles in the proposed guidance for accounting for customer options. Thus, an entity would recognise revenue from breakage as it performs under the contract on the basis of the estimated pattern of customers exercising their rights (ie a

proportional approach). That approach effectively increases the selling price of the individual goods or services transferred to the customer to include the revenue from the entity's estimate of unexercised rights. The boards decided that this approach represents the most appropriate pattern of revenue recognition for breakage because if an entity believed that customers would exercise all of their rights (ie if the entity did not expect any breakage), the entity might increase the price of its goods or services. For example, an airline that sells non-refundable tickets would presumably charge a higher price per ticket if there was no expectation of breakage.

- BC308 The boards also decided that an entity must be reasonably assured of a breakage amount to recognise revenue. Otherwise, the entity's performance obligation to stand ready to provide future goods or services could be understated.
- BC309 The boards considered but rejected the approach that would have required an entity to recognise estimated breakage as revenue immediately on the receipt of prepayment from a customer. The boards 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 understate the entity's obligation to stand ready to provide future goods or services.

Licensing and rights to use (paragraphs B33–B37)

- BC310 When developing application guidance on licensing and rights to use for the 2010 exposure draft, the boards observed that licensing arrangements often have characteristics that are similar to those of a lease. The primary similarity is that in both cases a customer purchases the right to use, but not own, an asset of the entity. Despite those similar characteristics, the current accounting for leases and licensing arrangements often differs. Accounting for a lease in accordance with existing standards often results in a lessor recognising income over time as the lessee receives the benefit of the use of the leased asset. In contrast, accounting for a licensing arrangement in accordance with existing standards often results in an entity recognising revenue at a point in time (typically upon commencement of the licence period).
- BC311 Consequently, the boards considered the differences between the nature of the promised asset in a licensing arrangement and the nature of the promised asset in a lease to determine whether those differences justify

a different pattern of revenue or income recognition. The boards considered differences relating to the following:

- (a) tangible versus intangible assets; and
- (b) exclusive versus non-exclusive rights.

BC312 The boards decided that it would be difficult to justify why the accounting for a promised asset should differ depending on whether the asset is tangible or intangible. Moreover, in the boards' conceptual frameworks, the discussion on the nature of assets deemphasises the physical nature of assets. Hence, the boards considered the exclusive versus the non-exclusive nature of rights.

BC313 Leases, by nature, grant a lessee exclusive rights because the lessor cannot grant the right to use a leased asset to more than one lessee at the same time. In contrast, for intellectual property, an entity can grant similar rights to more than one customer at the same time under substantially similar terms. Hence, the 2010 exposure draft proposed that an entity's performance obligation to grant exclusive rights would be satisfied over time. In contrast, an entity would satisfy a performance obligation to grant non-exclusive rights at a point in time. The 2010 exposure draft highlighted the fact that rights may be exclusive on the basis of many factors, such as time, geographical region, medium or distribution channel.

BC314 Most respondents to the 2010 exposure draft disagreed with the proposal that an entity should distinguish between an exclusive licence and a non-exclusive licence. Those respondents suggested that exclusivity does not affect the nature of an entity's performance obligation. Therefore, they believe that it is counter-intuitive to have different patterns of revenue recognition depending on whether a licence is exclusive. Respondents suggested that regardless of whether rights are exclusive, a customer obtains control of a promised asset at inception of a licence period when the customer is able to use and benefit from the licence. In addition, those respondents expressed concerns about the operability of the proposal and highlighted that any right to use is arguably exclusive.

BC315 The boards agreed with those respondents who expressed concerns about the proposed distinction between exclusive rights and non-exclusive rights. The boards considered whether another distinction would be appropriate and operable but decided that any distinction would be arbitrary and difficult to apply in practice because of the many ways in which an entity can grant rights to use intellectual property. Having

decided against distinguishing between types of licences and rights to use intellectual property, the boards considered two alternative views of the nature of an entity's performance obligation to grant to a customer a licence or right to use intellectual property:

- (a) a licence represents a performance obligation that the entity satisfies at the point in time when the customer obtains control of the licence (ie the use and benefit of the licence); or
- (b) a licence represents access to the entity's intellectual property that the entity satisfies continuously over the pattern of use of the underlying rights to use the entity's intellectual property by the customer.

BC316 The boards decided that a licence represents a performance obligation that an entity satisfies at the point in time when the customer obtains control of the licence. The boards preferred that view of the performance obligation because it focuses on the transfer of control of a promised asset, which is the core principle of the revenue model. That view was also more consistent with the principles in existing standards and current practice for accounting for licences and rights to use intellectual property. The boards observed that this conclusion is consistent with the tentative decision in the leases project. In July 2011, the boards decided that, in a lease, the lessor transfers a right of use asset at the commencement of the lease. In addition, the boards observed that a performance obligation for a licence satisfied at a point in time might still result in a pattern of revenue recognition over time in some circumstances because of the application of the other parts of the proposed revenue model. Specifically, an entity might recognise revenue over time because the entity is not reasonably assured to be entitled to an amount of consideration until an uncertainty is resolved in the future (for example, a sales-based royalty). A performance obligation for a licence or right to use intellectual property might also need to be combined with another promised good or service in accordance with the proposed requirements on identifying separate performance obligations. In that case, the pattern of revenue recognition might also be over time.

Repurchase agreements (paragraphs B38–B48)

BC317 When developing the proposed requirements on control, the boards considered how an entity would apply the proposed requirements to contracts in which an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract).

A forward or a call option (paragraphs B40–B42)

- BC318 If the entity has an unconditional obligation or right to repurchase an asset (ie a forward or call option), the boards decided that the customer does not obtain control of the asset and, therefore, no revenue would be recognised. That is because the customer is constrained in its ability to direct the use of and obtain substantially all the remaining benefits from the asset. Because the customer is obliged to return, or to stand ready to return, the asset to the entity, the customer cannot use up or consume the entire asset. Moreover, the customer cannot sell the asset to another party (unless that sale is subject to a repurchase agreement, in which case the customer's benefit from the sale is constrained).
- BC319 In theory, the customer is not constrained in its ability to direct the use of and obtain substantially all the benefits from the asset if the entity agrees to repurchase, at the prevailing market price, an asset from the customer that is substantially the same and is readily available in the marketplace. However, the boards noted that an entity would be unlikely to enter into such a transaction.
- BC320 In contrast, if the entity has a conditional right to repurchase an asset, the customer would obtain control of the asset and, therefore, revenue would be recognised subject to any sales return liability. Those agreements are common in the sale of perishable products and in the pharmaceutical industry to ensure that the customer (ie dealer or retailer) does not sell products to consumers beyond the expiry date and to protect the entity's reputation in the marketplace. In those circumstances, the boards decided that the substance of the repurchase agreement is the sale of a product with a put option and that revenue should be recognised accordingly.

A put option (paragraphs B43–B48)

- BC321 In the 2010 exposure draft, the boards decided that if the sale and repurchase agreement resulted in the entity's unconditional obligation to repurchase the asset at the customer's request (ie a put option), the customer would obtain control of the asset. That is because the customer is neither obliged to return the asset nor obliged to stand ready to do so. Therefore, the customer has the ability to direct the use of and obtain substantially all the remaining benefits from the asset (ie the customer can sell, use up or consume the entire asset and choose not to exercise the

put option). The boards decided that the entity should account for its obligation to stand ready to repurchase the asset consistently with the accounting for the sale of a product with a right of return (see paragraphs BC275–BC279). That results in the entity recognising the following:

- (a) a liability for its obligation to repurchase the asset measured at the amount of the consideration expected to be paid to the customer;
- (b) an asset for the entity's right to receive the asset upon settling that liability; and
- (c) revenue on transfer of the asset for the difference between the sales price of the asset and the liability recognised for the obligation to repurchase the asset.

BC322 Some respondents questioned whether that accounting would be appropriate in all cases in which a customer has a put option. For instance, some noted that, in some such cases, the contract appears economically to be similar to a lease (with a purchase option) rather than a right of return. That might be the case if the entity is required to repurchase the asset at a price that is lower than the original sales price and the surrounding facts and circumstances indicate that the customer will exercise its put option. In those cases, the difference between the original sales price and the repurchase price can be viewed as the amount the customer pays for a right to use the asset, compensating the entity for the decline in the value of the asset. Some respondents noted that in other cases, the contract is in effect a financing arrangement.

BC323 The boards agreed with these respondents and decided that if the customer has an unconditional right to require the entity to repurchase the asset at a price that is lower than the original sales price and the customer has a significant economic incentive to exercise that right, then the customer would not obtain control of the asset. In those cases, the boards decided that the existence of the option effectively constrains the ability of the customer to direct the use of and obtain substantially all the remaining benefits from the asset. Although the customer is not obliged to exercise its put option, the fact that it has a significant economic incentive to exercise that right means that it would likely incur a loss if it did not do so (for example, the repurchase price may be set significantly above the expected market value of the asset at the date of the repurchase). For similar reasons, the boards decided that if the customer has the unconditional right to require the entity to repurchase the asset at a price that is greater than the original sales price and higher than the expected market value of the asset, the customer would not obtain control of the asset.

Accounting for repurchase agreements in which the customer does not obtain control of the asset

- BC324 If an entity enters into a contract with a repurchase agreement and the customer does not obtain control of the asset, the boards decided that:
- (a) the contract should be accounted for as a lease in accordance with IAS 17 *Leases* or ASC Topic 840 if the effect is that the customer is paying for a right to use the asset; or
 - (b) the contract is a financing arrangement if the effect is that the entity is paying interest.
- BC325 To ensure consistent accounting in IFRSs and US GAAP for a financing arrangement that arises from a contract with a customer, the boards decided to provide guidance consistent with ASC Subtopic 470-40 on product financing arrangements. Consequently, the FASB decided to replace ASC Subtopic 470-40. It noted that the remaining guidance in ASC Subtopic 470-40 addresses situations in which an entity arranges for another party to purchase products on its behalf and agrees to purchase those products from the other party. In those cases, the entity is required to recognise the products as an asset and to recognise a related liability when the other party purchases the product. The FASB noted that the proposed model would result in similar accounting when the other party acts as an agent of the entity (ie the other party does not obtain control of the products).

Transition, effective date and early adoption (paragraphs C1–C4)

Transition (paragraphs C2–C4)

- BC326 The boards affirmed their proposal in the 2010 exposure draft that an entity should apply the proposed requirements retrospectively in accordance with IAS 8 or the requirements on accounting changes and error corrections in ASC Topic 250. Retrospective application would ensure that all contracts with customers are recognised and measured consistently both in the current period and in the comparative periods presented regardless of whether those contracts were entered into before or after the requirements became effective. Consequently, revenue recognised in the current period would be understandable and comparable because an entity would account for all of its contracts with customers on the same basis. Furthermore, retrospective application

would provide users of financial statements with useful trend information across the current period and comparative periods. Feedback received from users confirmed that retrospective application is particularly important for them to be able to understand trends in revenue, which are significant to the financial statements.

- BC327 Other transition approaches considered by the boards were for an entity to apply the proposed requirements on a prospective basis, either for all new contracts entered into after the effective date or for all contracts (new and existing) from that date. The boards rejected those alternatives because revenue recognised after the effective date would not be comparable with revenue recognised before that date, thereby impairing comparability and the usefulness of trend information. Moreover, if the proposals were applied prospectively only for new contracts, the recognition and measurement of revenue would not be comparable in the current period or in any subsequent periods in which revenue is recognised from contracts that were entered into before and after the effective date.
- BC328 Many respondents to the 2010 exposure draft commented that applying the proposed requirements retrospectively would be burdensome, especially for those entities with long-term contracts or with large and complex multiple-element arrangements. The main concerns raised by those respondents were:
- (a) historical information may be inaccessible because it is retained in a wide range of systems and manual records that change over time;
 - (b) contracts may have started before the issuance of the standard and information to apply the requirements retrospectively may not have been collected or retained;
 - (c) the information needed to estimate stand-alone selling prices of goods or services in a contract with many performance obligations may not exist, especially when that good or service was not sold separately; and
 - (d) entities make assumptions and estimates throughout a contract's life and it may not be possible to recreate the circumstances that apply historically without the use of hindsight.
- BC329 The boards decided that although retrospective application would generally impose increased preparation costs, those would be outweighed by the increased benefits to users of financial statements. Consequently, the boards considered how the burden of retrospective

application could be eased while, at the same time, retaining the benefits of comparability and consistency that retrospective application would provide. The boards noted that some of those concerns would be addressed by:

- (a) the existing requirements in IAS 8 and ASC Topic 250, which limit the retrospective application of an accounting policy if it is impracticable;
- (b) changes made to the proposed requirements during the re-deliberations on the 2010 exposure draft, which have brought some of the requirements closer to existing practices (see the summary of changes from the 2010 exposure draft in the appendix to the Basis for Conclusions); and
- (c) specifying a long lead time between issuing the standard on revenue from contracts with customers and its effective date, which would reduce both the historical information that needs to be collected and the extent that hindsight is needed to apply that standard.

BC330 To further ease the burden of transition without sacrificing comparability, the boards also decided to modify the retrospective application requirement by allowing an entity to elect to use one or more of the following reliefs.

Relief	Rationale
<i>Relief that reduces the number of contracts that require restatement</i>	
<p>For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.</p>	<p>In considering whether an entity should be required to review and restate all contracts completed before the date of initial application, the boards decided that trend information should be preserved for those completed contracts that span annual reporting periods. Therefore, the boards decided to limit the relief to only those contracts that begin and end within the same annual reporting period because the amount and timing of revenue recognition relating to those contracts would not change between annual reporting periods. The boards noted that this proposed relief would significantly reduce the transition burden on those entities that have a large number of short-term contracts.</p> <p>A consequence of this relief is that revenue reported in <i>interim</i> periods before and after the effective date would not necessarily be accounted for on a comparable basis. The boards expect that an entity would not use this relief if it operates in an industry in which comparability across interim reporting is particularly important to users of financial statements.</p> <p style="text-align: right;"><i>continued...</i></p>

<i>...continued</i> Relief	Rationale
<i>Relief that simplifies how an entity restates contracts with customers</i>	
<p>For contracts completed before the date of initial application and that have variable consideration, an entity is permitted to use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.</p>	<p>Full retrospective application of the standard in accordance with IAS 8 or ASC Topic 250 would require an entity to determine the estimates it would have made at each of the reporting dates in the comparative periods. The boards considered that making those estimates in the comparative years would increase the complexity and costs of retrospective application.</p> <p>By allowing an entity to use hindsight in estimating variable consideration, the boards decided that transition would be simplified for the following reasons:</p> <ul style="list-style-type: none"> • The amount of information an entity would need to collect contemporaneously through the transition period would be reduced. • The entity would not need to determine the transaction price at each period end. <p style="text-align: right;"><i>continued...</i></p>

<i>...continued</i> Relief	Rationale
<i>Reliefs that simplify retrospective application of other aspects of the proposed requirements</i>	
<p>An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognised previously for that contract in accordance with the requirements that were effective in those comparative periods.</p>	<p>The boards propose this relief from retrospective application for the following reasons:</p> <ul style="list-style-type: none"> • Revenue would not be restated and, therefore, the trend information for revenue would be unaffected. • Under existing requirements, an entity may not have recognised a liability for a performance obligation that would be onerous under the new standard. Consequently, it may be unduly costly and burdensome for an entity to evaluate whether a contract would have been onerous at each reporting date in the comparative periods. <p style="text-align: right;"><i>continued...</i></p>

<i>...continued</i> Relief	Rationale
<i>Reliefs that simplify retrospective application of other aspects of the proposed requirements</i>	
<p>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 (as specified in paragraph 119).</p>	<p>The boards decided that the disclosure of the remaining performance obligations (as would be required by paragraph 119) should not be required for periods presented before the date of initial application of the revenue standard for the following reasons:</p> <ul style="list-style-type: none"> • The disclosure would be most useful for the current period. • The disclosure could be burdensome to prepare for comparative years, especially when trying to avoid the use of hindsight to estimate the transaction price and the expected timing of satisfaction of those performance obligations.

BC331 Because entities have been granted some relief from applying the proposed requirements on a fully retrospective basis, the boards decided that the existing transitional disclosure requirements of IAS 8 and ASC Topic 250 on accounting changes and error corrections should be supplemented by disclosures that explain to users the relief employed and, to the extent reasonably possible, a qualitative assessment of the likely effect of applying those reliefs.

Effective date and early adoption (paragraph C1)

- BC332 The 2010 exposure draft did not specify a possible effective date or whether the proposed requirements could be adopted early. At that time, the boards decided that they would collectively consider the effective dates and early adoption of all of the standards they had targeted to issue in 2011, including revenue recognition. Subsequently, the boards sought feedback from interested parties through a number of activities, including the following:
- (a) the IASB's *Request for Views on Effective Dates and Transition Methods* and the FASB's Discussion Paper *Effective Dates and Transition Methods* (October 2010);
 - (b) the boards' joint investor outreach questionnaire (April 2011); and
 - (c) consultation with systems providers and preparers.
- BC333 The feedback indicated that stakeholders will require some time to evaluate and plan their individual application and transition processes. For this reason and the fact that the final standard would require retrospective application, the boards decided that they should allow a long lead time between issuing the final standard and the effective date.
- BC334 The boards decided that the effective date of the revenue standard should be set to ensure that the start of the earliest comparative period for an entity required to present two comparative annual periods (in addition to the current annual period) would be a few months after the standard is issued. Consequently, the boards noted that based on their current timetable for the project, the effective date of the revenue standard would be no earlier than annual periods beginning on or after 1 January 2015.
- BC335 The FASB decided not to allow entities to adopt the standard early because doing so would reduce the comparability of financial reporting in the period up to the effective date of the standard. However, the IASB decided that it would permit early adoption of the standard. The IASB noted that the standard would improve accounting for revenue and, thus, entities should not be precluded from adopting the standard before its effective date. Furthermore, the IASB noted that the standard should resolve some pressing issues in practice arising from existing requirements. The boards observed that the IASB-only decision to permit

early adoption should not result in differences after the effective date in the accounting of revenue between entities applying US GAAP and those entities applying IFRSs that adopt the standard early, even for contracts that straddle the effective date.

Benefits and costs

- BC336 The objective of financial statements is to provide information about an entity's financial position, financial performance and cash flows that is useful to a wide range of users in making economic decisions. To attain that objective, the boards try to ensure that the proposed requirements will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. The costs of implementing a new standard might not be borne evenly; however, both the users of financial statements and entities benefit from improvements in financial reporting that facilitate the functioning of markets for capital, including credit and the efficient allocation of resources in the economy.
- BC337 The evaluation of costs and benefits is necessarily subjective. In making their judgement, the boards considered the following:
- (a) the costs incurred by preparers of financial statements;
 - (b) the costs incurred by users of financial statements when information is not available;
 - (c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information; and
 - (d) the benefit of better economic decision-making as a result of improved financial reporting.
- BC338 The boards developed requirements that would result in entities recognising revenue on a consistent and comparable basis for a wide range of contracts with customers. By accounting for those contracts consistently, the proposed requirements would address many of the weaknesses and inconsistencies inherent in existing revenue requirements, which have contributed to the existence of diverse practices in the recognition of revenue and, as a result, in frequent requests for authoritative requirements on applying existing requirements to specific transactions or other emerging issues. Furthermore, the proposed requirements provides a stable and durable framework that should address revenue recognition issues associated with new types of transactions and industries that emerge in the future.

- BC339 The proposed requirements would also improve comparability in the recognition, measurement and disclosure of revenue across transactions and across entities operating in various industries. Users have indicated that comparable revenue information is useful when assessing the financial performance of an entity and assessing financial performance across a number of entities. Moreover, a common revenue standard would make the financial reporting of revenue comparable between entities that prepare financial statements in accordance with IFRSs or US GAAP.
- BC340 In responding to the proposals in the 2010 exposure draft, many preparers and some users did not perceive significant weaknesses in some existing revenue requirements or in the financial information resulting from applying those requirements to some industries. Therefore, those preparers and users questioned whether the benefits from applying a new standard in some industries would be justified by the costs involved in implementing that new standard. However, the boards decided that the overall benefits of financial reporting that would result from a comprehensive revenue standard being applied consistently across different industries, jurisdictions and capital markets outweigh the concerns about cost-benefit assessments in particular industries. In addition, the boards noted that the amount of change for some entities should not be significant. That is because some of the proposed requirements are broadly consistent with existing revenue recognition requirements or generally accepted practices.
- BC341 Nevertheless, the proposed requirements would change some existing revenue recognition practices and, consequently, some entities would need to make systems and operational changes to comply with those requirements. For example, some preparers have indicated that systems and operational changes would be necessary to estimate variable consideration and to account for the effects of the time value of money and contract options. The boards clarified that many entities would not need to develop systems to account for each contract individually, especially for entities that have a large volume of similar contracts with similar classes of customers. In those cases, the boards noted that entities should be able to apply the proposed requirements to a portfolio of similar contracts. In addition, some practical expedients have been added to the proposed requirements to simplify compliance with those requirements in circumstances in which the boards determined that the expedient would have a limited effect on the amount or timing of revenue recognition. As a result of those changes and clarifications, the boards expect that the costs of the systems and operational changes would be incurred primarily during the transition from existing

standards to the new revenue standard, whereas the benefits resulting from increased consistency and comparability in the recognition of revenue would be ongoing. To ease those preparation costs and complexities associated with the transition to the new standard, the boards proposed a series of reliefs that the entity can choose to use when applying the proposed requirements retrospectively.

- BC342 The proposed disclosures are more robust than disclosure requirements in existing standards. Therefore, the proposed disclosures should result in an entity disclosing additional information to users that explains more clearly the relationship between an entity's contracts with customers and the revenue recognised by the entity in a reporting period. Many users commented that the proposed disclosures would address deficiencies that currently exist in revenue disclosures. In contrast, many preparers expressed concerns about the volume and specificity of the proposed disclosures. The boards noted that each of the proposed disclosures would provide useful information to users of financial statements if that information disclosed is material to understanding the entity's financial position, performance and cash flows. Consequently, the boards clarified that, in accordance with existing requirements on materiality, an entity would not be required to disclose information that is not material.
- BC343 Respondents to the 2010 exposure draft also indicated that although they did not disagree with some of the proposals, they perceived that in some cases, the costs of implementing them would outweigh the benefits that would be received. As a result of these comments, members and staff of the boards have consulted extensively across a wide range of industries and jurisdictions (see paragraphs BC7–BC9) to better understand some of the operational issues arising from those proposals. The boards considered that feedback in their re-deliberations and, as a result, decided to modify or clarify many aspects of the proposed revenue recognition model to reduce the burden of implementing and applying the proposed requirements. Discussion of these considerations and the resulting changes in different aspects of the model is included throughout the Basis for Conclusions. (For example, paragraphs BC131–BC138 include discussion of the feedback received and changes made to the principles for measuring the transaction price when it includes variable consideration.) The boards will continue to consult with representatives from various industries and jurisdictions following publication of the proposed requirements.

BC344 On balance, the boards decided that the proposed requirements would improve financial reporting under IFRSs and US GAAP at a reasonable cost. In arriving at that conclusion, the boards acknowledged that the assessments of costs versus benefits would be different under IFRSs and US GAAP.

Consequential amendments

Sales of assets that are not an output of an entity's ordinary activities

- BC345 ASC Subtopic 360-20 on real estate sales provides guidance for recognising profit on all real estate sales, regardless of whether real estate is an output of an entity's ordinary activities.
- BC346 A contract for the sale of real estate that is an output of an entity's ordinary activities meets the definition of a contract with a customer and, therefore, would be within the scope of the proposed requirements. Consequently, the FASB considered the implications of retaining the guidance in ASC Subtopic 360-20 for other contracts. The FASB noted that retaining the existing requirements could result in an entity recognising the profit or loss on a real estate sale differently depending on whether the transaction is a contract with a customer. However, economically there is little difference between the sale of real estate that is an output of the entity's ordinary activities and the sale of real estate that is not. Hence, the difference in accounting should relate only to the presentation of the profit or loss in the statement of comprehensive income—revenue and expense or gain or loss.
- BC347 Therefore, the FASB decided to amend ASC Subtopic 360-20 to require an entity to apply the recognition and measurement principles of the proposed requirements to contracts for the sale of real estate that is not the output of the entity's ordinary activities. However, the entity would not recognise revenue but instead would recognise a gain or a loss. The gain or loss would be recognised when the entity transfers control of the promised asset to the purchaser. The amount of gain or loss would be determined using the proposals for determining the transaction price (including the constraint to amounts to which the entity is reasonably assured to be entitled).

- BC348 The FASB also decided to specify that an entity should apply the recognition and measurement principles of the proposed requirements to contracts for the derecognition of non-financial assets (including in-substance real estate) in non-revenue transactions, such as tangible assets within the scope of ASC Topic 360 on property, plant and equipment and intangible assets within the scope of ASC Topic 350 on goodwill and other intangibles. The primary reason for that decision was the lack of clear guidance in US GAAP on accounting for the derecognition of those assets when they are not an output of an entity's ordinary activities and do not constitute a business or non-profit activity.
- BC349 In IFRSs, an entity selling an asset within the scope of IAS 16 *Property, Plant and Equipment*, IAS 38 or IAS 40 *Investment Property* applies the recognition principles of IAS 18 to determine when to derecognise the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with US GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed requirements to sales of assets within the scope of those standards. The IASB decided that a *reasonably assured* constraint on the amount of consideration used in determining the gain or loss recognised should also apply to the sale of assets that are not an output of the entity's ordinary activities. This is because an entity faces similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.

Transition for first-time adopters of IFRSs

- BC350 In their re-deliberations of the transition requirements, the IASB considered whether the transitional relief in paragraph C3 (see paragraph BC330) should also apply to entities applying IFRS 1 *First-time Adoption of International Financial Reporting Standards*, in which case the IASB would need to amend IFRS 1. The IASB decided that a first-time adopter should be permitted to use three of the reliefs in paragraph C3, specifically that:
- (a) for contracts completed before the date of the first IFRS reporting period, an entity need not restate contracts that begin and end within the same annual reporting period;
 - (b) for contracts completed before the date of the first IFRS reporting period and that have variable consideration, an entity may use the

transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods; and

- (c) for all periods presented before the date of the first IFRS reporting period, an entity need not disclose the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue (as specified in paragraph 119).

BC351 The IASB observed that IFRS 1 requires that the accounting policies effective at the end of the first IFRS reporting period are applied to all reporting periods from the date of transition to IFRSs onwards. This is identical in effect to retrospective application for entities already applying IFRSs. Some IASB members also noted that in many jurisdictions existing revenue standards are similar to current IFRSs. In those jurisdictions, the starting point for transition for a first-time adopter will be similar to those entities already applying IFRSs. For that reason, the IASB concluded that those reliefs should also apply to a first-time adopter because both first-time adopters and entities that already apply IFRSs would face similar challenges. The IASB decided, however, that the relief proposed for onerous contracts in paragraph C3(c) would not be consistent with the objective of IFRS 1 (ie to ensure that a first-time adopter's financial statements are comparable for all periods presented).

BC352 *[Paragraphs BC352–BC370 in the Basis for Conclusions on the FASB exposure draft which discuss the application to non-public entities are not used in the Basis for Conclusions on the IASB exposure draft.]*

Alternative views on exposure draft

Alternative view of Jan Engström

- AV1 Mr Engström voted against publication of the exposure draft.
- AV2 Mr Engström strongly supports the objective of taking a step towards global convergence by developing a common revenue standard for IFRSs and US GAAP. He also strongly supports the core principle proposed in paragraph 4 of the exposure draft and he supports the proposed requirements that would give effect to that principle. However, Mr Engström is concerned about the extent of the proposed disclosure requirements in the exposure draft. Mr Engström questions whether the benefits to users of the resulting disclosures would justify the costs that preparers would incur to provide those disclosures.
- AV3 Mr Engström's decision to vote against publication is triggered by the proposal to amend IAS 34 *Interim Financial Reporting* to specify that an entity would be required to provide in its interim financial report some of the disclosures about revenue and contracts with customers proposed for annual financial statements. Mr Engström believes that it is inappropriate to require such disclosures in interim financial reports without undertaking a holistic review of IAS 34.

The following alternative view expressed by a member of the FASB is not part of the IASB's exposure draft, but has been included for information.

Alternative view of Thomas J Linsmeier

AV4 Mr Linsmeier disagrees with the publication of this proposed Update* for three primary reasons:

- (a) First, he believes that the proposed model has introduced exceptions that permit revenue to be recognised in a manner that is inconsistent with the core principle on which the entire standard is purportedly based. That core principle is that an entity should recognise revenue to depict the transfer of promised goods or services to customers. Under this principle, revenue is recognised if and when a customer receives a good or service promised under the contract. Exceptions to this core principle call into question whether the objectives of the proposed standard are being met, which include the development of a robust and consistent framework that improves the comparability of revenue recognition practices across entities, markets, and jurisdictions.
- (b) Second, Mr Linsmeier objects to the publication of the proposed guidance because he believes that it results in inconsistent guidance for similar economic circumstances within and across standards. The existence of significant inconsistencies within and across standards makes it difficult to apply the proposed model to specific fact patterns that are not addressed in this proposed Update and increases the likelihood that additional circumstance-specific implementation guidance will be needed. In addition, it suggests that the proposed model again fails to meet the objectives for issuing one standard for recognising revenue from contracts with customers by failing to provide a consistent recognition framework.
- (c) Third, Mr Linsmeier objects to the publication of this proposed Update because it fails to provide operable, auditable guidance for determining either the amounts or timing of certain items required to be recognised under the proposed guidance.

* The FASB's exposure draft is a proposed Accounting Standards Update (proposed update).

- AV5 Mr Linsmeier believes that there are multiple examples in the standard that support each of his concerns. The items discussed below are included only to illustrate the potential nature and extent of these issues.

Exceptions to the core revenue recognition principle

- AV6 One of the most substantive revisions made to the model in this proposed Update is the introduction of criteria for determining when performance obligations are satisfied over time. One of these new criteria specifies that a performance obligation should be considered satisfied and revenue should be recognised over time by the selling entity when it has the right to payment for performance completed to date as long as it expects to fulfil the contract as promised and the activity under the contract is not creating an asset with an alternate use to the selling entity (for example, it is not building inventory that the entity could sell to another customer). This criterion permits recognition of revenue over time, even when the selling entity has not transferred to the customer any promised goods or services under the contract. For example, it permits an architectural design firm to recognise revenue before the completion of its design drawings and the delivery of its unique work product to a specific customer as long as the design firm has the right to payments for design activities undertaken to date.
- AV7 This outcome is inconsistent with a revenue recognition model based on the transfer of a promised good or service to the customer and calls into question whether there is one core principle underlying the proposed guidance or whether the proposed model has introduced a different principle for recognising revenue in certain situations that is based only on activities being performed by the selling entity under the contract.

Inconsistencies within the proposed Update and across Topics

- AV8 Three illustrative examples of significant inconsistencies in the accounting for similar circumstances both within the proposed Update and across related or proposed guidance in other standards include (a) the accounting for revenue to be recognised under licensing arrangements, sales-based royalty arrangements for use of intellectual property, and leasing arrangements, (b) the accounting for certain put options as leases under the proposed Update regardless as to whether the contract meets the definition of a lease, and (c) the accounting for onerous revenue contracts with customers.
- (a) The economics of licences, royalty arrangements, and leases are very similar; each of these contracts provides a customer with the

right to use an asset for a period of time. Within this proposed Update, the timing and amount of revenue that is recognised differ for licenses and sales-based royalty payments for intellectual property and that guidance differs still from the guidance for recognising revenue in the leasing standard being developed by the two boards. The comparability and consistency of accounting for similar economic circumstances are impaired by these differences, reducing the decision usefulness of the information provided to users of financial statements.

- (b) This proposed Update also indicates that a put option that requires the selling entity to repurchase an asset at the customer's request at a price that is lower than the original selling price of an asset should be accounted for as a lease, if at contract inception the customer has a significant economic incentive to exercise its right. The scope of the revenue standard excludes contracts that meet the definition of a lease. This guidance, therefore, effectively overrides the scope requirements in both the proposed revenue standard and the proposed leasing standard by requiring contracts that are in the scope of the proposed revenue standard that do not meet the definition of lease to be accounted for as a lease.
- (c) Mr Linsmeier also finds it inconsistent that the proposed Update only addresses the accounting for losses on onerous contracts for contracts with revenue being recognised over time and then only for those contracts that at inception are expected to have performance obligations that are satisfied over periods of time greater than one year. For other contracts in the scope of this proposed Update, the Basis for Conclusions (paragraph BC210) indicates that contracts with performance obligations satisfied at a point in time typically result in the creation of related assets that would be the subject of impairment testing in other standards. However, existing US GAAP provides inadequate guidance on the impairment of inventory that is promised in a sales contract when an entity does not have such inventory in stock and does not yet have a purchase commitment for the inventory. Hence, Mr Linsmeier believes that the scope of the onerous test will fail to require the immediate recognition of a loss on some performance obligations that an entity expects to be loss making. In addition, he believes that existing and proposed impairment guidance, in its totality, will result in arbitrary differences in the timing and amount of recognition of impairment losses that could significantly challenge the ability of users seeking to compare and

understand the nature of the onerous contract issues for different types of revenue contracts.

Concerns about operability and auditability of the proposed guidance

AV9 Finally, the following three circumstances provide examples of situations in which Mr Linsmeier believes that additional guidance is needed to make this proposed Update both operable and auditable:

- (a) First, guidance is needed for evaluating whether the appropriate amortisation period is being employed for contract costs recognised as assets. The proposed Update fails to provide robust conditions for evaluating when the amortisation period is permitted to extend beyond existing contracts to include anticipated contract periods, thereby providing a significant earnings management opportunity by permitting the entity to either assert or not assert that an existing contract will be renewed.
- (b) Second, under the proposed guidance, variable consideration should be recognised only when it is *reasonably assured*, a term that suggests that a recognition threshold must be exceeded for recognition to occur. No guidance is provided in the proposed Update that specifies the threshold that must be exceeded for revenue to be considered reasonably assured. Is that threshold consistent with the high confidence threshold used by accounting firms when implementing the concept of reasonable assurance in the US auditing literature, or if no threshold need be met, should not a better term be used?
- (c) Third, additional guidance is needed for determining when an expected value or most likely amount should be used to estimate variable consideration in a transaction price. The proposed model provides a measurement objective and then suggests possible circumstances in which these alternative measurement methods *may* (and by implication *may not*) be used. This challenges the ability of auditors to determine whether the appropriate method to meet the measurement objective has been selected.

Conclusion

AV10 Mr Linsmeier believes that many of the issues he has identified have arisen in an effort to minimise differences with current practice by including in the proposed standard past guidance in existing literature. Mr Linsmeier believes that the proposed model for revenue recognition

could be made suitable for issuance if it were to eliminate specific guidance that is inconsistent or contradictory and, instead, rely on core principles without exception to provide a consistent framework for recognising revenue. In addition, Mr Linsmeier believes that to best capture the economics of revenue transactions, the revenue recognition standard also must address cost recognition comprehensively, including the recognition of losses when costs are expected to exceed revenues in onerous contracts. Finally, efforts need be undertaken to ensure that the guidance in the proposed standard are made operable and auditable by specifying the conditions that must be met when key judgements are required.

Appendix

Summary of changes from the 2010 exposure draft

The following table summarises the changes to the boards' June 2010 proposals in response to feedback received:

Steps to apply the proposals	Description of changes to the proposals
Step 1: Identify the contract(s) with the customer	<ul style="list-style-type: none"> • Changed the proposed <i>indicators</i> on combining contracts to <i>criteria</i>. The criteria are limited to contracts that are entered into at or near the same time with the same customer (or related parties). Added a criterion for goods or services across contracts that are a single performance obligation. • Eliminated the proposal on contract segmentation (but moved the principle to Step 4 on allocating the transaction price). • Revised the proposal on contract modifications to reduce the instances in which an entity would account for a modification on a cumulative catch-up basis.
Step 2: Identify the separate performance obligations in the contract	<ul style="list-style-type: none"> • Retained the definition of a <i>performance obligation</i> subject to the deletion of the term <i>enforceable</i> (to clarify the June 2010 proposals). • Clarified the proposals for identifying separate performance obligations (distinct goods or services) mainly by moving the guidance on a significant contract management service from the application guidance/basis into the proposed standard and by deleting reference to <i>distinct profit margin</i> in the proposed standard.

<p>Step 3: Determine the transaction price</p>	<ul style="list-style-type: none"> • Modified the definition of <i>transaction price</i> to refer to the amount to which the entity expects to be <i>entitled</i> rather than the expected amount to be <i>received</i>. • Modified the proposals on determining the transaction price as follows: <ul style="list-style-type: none"> • Collectibility: credit risk no longer included in the transaction price. Accounted for similarly to current practice (except for the presentation adjacent to revenue). • Time value of money: added a one-year practical expedient and clarified when a financing component is significant. • Variable consideration: either an expected value or a most likely amount is required (to simplify the proposals, which would have required a probability-weighted estimate in all cases).
<p>Step 4: Allocate the transaction price</p>	<ul style="list-style-type: none"> • Clarified that it may be appropriate for an entity to estimate a selling price using a residual approach if the price of a good or service is highly variable or uncertain. • Added requirements for when it is appropriate to restrict allocations of discounts, contingent payments and changes in the transaction price to only some promised goods or services. Those requirements use the 2010 exposure draft's principle of price independence (from contract segmentation) but have specific criteria to clarify when goods or services are priced independently (ie the payment terms relate to the particular good or service and the amount is consistent with the objective of allocating the transaction price).

<p>Step 5: Recognise revenue when a performance obligation is satisfied</p>	<ul style="list-style-type: none"> • Added <i>risks and rewards of ownership</i> as an indicator of when control is transferred at a point in time. • Added criteria for determining when a performance obligation is satisfied over time. • Retained the objective of measuring progress towards completion of a performance obligation, but: <ul style="list-style-type: none"> • clarified the discussion of alternative methods (ie output and input methods); • added requirements for uninstalled materials; • added requirements for reasonable measures of progress; and • clarified the meaning of <i>abnormal costs</i>. • Changed the proposed constraint from an entity's <i>reasonable estimate</i> of the transaction price to the entity being <i>reasonably assured</i> to be entitled to the amount of consideration recognised as revenue to date. No change made to the factors to consider when making that determination other than clarifying that an entity is not reasonably assured to be entitled to a sales-based royalty amount until the occurrence of the event that makes the payment due.
Other issues	
<p>Warranties</p>	<ul style="list-style-type: none"> • Revised the proposed requirements to require an entity to account for some warranties as a cost accrual, which is more consistent with current practice.

Licences and rights to use	<ul style="list-style-type: none"> Eliminated the distinction between non-exclusive and exclusive licences. All rights to use are transferred at a point in time (subject to the separation criteria and the proposal to constrain cumulative revenue recognised at the amount to which the entity is reasonably assured to be entitled).
Onerous test	<ul style="list-style-type: none"> Modified the scope of the test to a performance obligation that an entity satisfies over a period of time greater than one year. Added requirements for which costs to include when performing the test (an entity would use the lower of the direct costs to satisfy the performance obligation and the amount the entity would pay to exit the performance obligation, if permitted under the contract).
Acquisition costs	<ul style="list-style-type: none"> Changed the proposal in the 2010 exposure draft so that the incremental costs of obtaining the contract (for example, sales commissions) would be recognised as an asset. As a practical expedient, permitted the option to recognise acquisition costs as an expense if the contract is one year or less. Added disclosure requirements.

Fulfilment costs	<ul style="list-style-type: none"> • Clarified how an entity would amortise the asset recognised from fulfilment costs (ie the asset would be amortised in accordance with the pattern of transfer of goods or services to which the asset relates, which might be provided in specific anticipated contracts). • Clarified the requirements for how an entity would test the asset for impairment (ie revised the wording for pre-contract costs and specified whether a reversal of an impairment is required). • Added disclosure requirements. • Clarified the scope of the cost requirements developed as part of the revenue project.
Sale and repurchase agreements	<ul style="list-style-type: none"> • Added requirements to specify that an entity should account for a sale with a put option as a lease if the customer has a significant economic incentive to exercise the option.
Disclosures	<ul style="list-style-type: none"> • Limited the instances in which an entity would provide a maturity analysis of remaining performance obligations.
Breakage	<ul style="list-style-type: none"> • Added guidance on how to apply the model when the customer purchases a material right but chooses not to fully exercise that right (ie breakage). That guidance is consistent with the 2010 exposure draft's guidance in the example on customer loyalty points.
Transition	<ul style="list-style-type: none"> • Provided some specified reliefs for transitioning to the proposed standard on a retrospective basis.

Appendix

Amendments to the Basis for Conclusions on other IFRSs

This appendix describes the amendments to other IFRSs that the Board expects to make when it finalises the proposed IFRS. Amended paragraphs are shown with new text underlined and deleted text struck through.

IFRS 3 Business Combinations

BCA1 Paragraph BC245 is footnoted as follows:

- * [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

BCA2 Paragraph BC14 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA3 Paragraph BC71 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA4 Paragraph BC72 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue* and completed the Board's revenue recognition project.

BCA5 Paragraph BC119 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. The guidance on the accounting for incremental costs directly attributable to securing an investment management contract was replaced by guidance in IFRS X.

IFRS 9 *Financial Instruments* (November 2009)

BCA6 The reference to IAS 18 *Revenue* in paragraph BC86(a) is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. Dividends are accounted for in accordance with paragraph 5.4.5.

IFRS 9 *Financial Instruments* (October 2010)

BCA7 The reference to IAS 18 *Revenue* in paragraph BC5.25 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. Dividends are accounted for in accordance with paragraph 5.7.6.

IFRS 13 *Fair Value Measurement*

BCA8 Paragraph BCA114 and the related heading are deleted.

IAS 16 *Property, Plant and Equipment*

BCA9 Paragraph BC24 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. IFRS X excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers, other than the parties to the exchange.

BCA10 Paragraph BC34 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue* and amended paragraph 69 of IAS 16 for consistency with the new requirements in [draft] IFRS X.

BCA11 Paragraph BC35D is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

IAS 23 Borrowing Costs

BCA12 Paragraph BC27 and the heading above paragraph BC27 are deleted.

IAS 36 Impairment of Assets

BCA13 Paragraph BCZ5 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 11 *Construction Contracts*. [draft] IFRS X deals with the impairment of some assets arising from contracts with customers, therefore paragraph 2 has been amended.

IAS 39 Financial Instruments: Recognition and Measurement

BCA14 Paragraphs BC20, BC21 and BC222(a) and (b) are footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue* and amended paragraph 47 of IAS 39 for consistency.

BCA15 The reference to IAS 18 in paragraph BC23D is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA16 Paragraph BC33 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. The guidance in IAS 18 relating to fees to be included in the effective interest rate was relocated to paragraph AG8A, AG8B and AG8C of IAS 39.

IAS 40 Investment Property

BCA17 Paragraph B63(f) is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 11 *Construction Contracts*.

BCA18 Paragraph B67(d) is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue* and amended paragraph 67 of IAS 40 for consistency with the new requirements in [draft] IFRS X.

IAS 41 Agriculture

BCA19 Paragraph B4(a)(iii) is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X does not deal with revenue arising from 'natural increases in herds, and agricultural and forest products'.

BCA20 Paragraph B71 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

IFRIC 12 Service Concession Arrangements

BCA21 The reference to IAS 18 *Revenue* in paragraph BC27 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA22 Paragraph BC30 and BC31 are footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 11 *Construction Contracts* and IAS 18 *Revenue*. [draft] IFRS X requires revenue to be recognised as an entity satisfies a performance obligation by transferring a promised good or service to a customer. [draft] IFRS X measures the revenue by (a) determining the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer and (b) allocating that amount to the separate performance obligations.

BCA23 Paragraph BC33 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X requires an entity to measure non-cash consideration at fair value, unless the entity cannot reasonably estimate the fair value of the non-cash consideration. In such cases, [draft] IFRS X requires the entity to measure the consideration indirectly by reference to the standalone selling price of the goods or services promised in exchange for the consideration.

BCA24 Paragraph BC45 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X requires an entity to recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset. The operator has an unconditional right to receive cash when nothing other than the passage of time is required before payment of that consideration is due.

IFRIC 17 *Distributions of Non-cash Assets to Owners*

BCA25 Paragraph BC33 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X does not deal with dividends. Dividends should be accounted for in accordance with IFRS 9, or IAS 39 if applicable.

SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*

BCA26 Paragraph 9 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA27 The quote from IAS 18 in paragraph 10 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*.

BCA28 The quote from IAS 18 in paragraph 11 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X excludes non-monetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers, other than the parties to the exchange.

SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease

BCA29 Paragraph 12 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 11 *Construction Contracts*. [draft] IFRS X requires contracts to be combined if they meet specified criteria.

BCA30 Paragraph 16 is footnoted as follows:

- * [draft] IFRS X *Revenue from Contracts with Customers* issued in [201X] replaced IAS 18 *Revenue*. [draft] IFRS X eliminated the guidance on recognising revenue on the execution of a significant act.