



New on the Horizon: Revenue recognition for technology companies

International Financial Reporting Standards
August 2010

Foreword

In the exposure draft ED/2010/6 *Revenue from Contracts with Customers* the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) propose a new model for revenue recognition.

Under these joint proposals, entities, whether reporting under IFRSs or US GAAP, would apply a common approach to revenue recognition across transactions and across industries for the first time. For users of IFRSs, the proposed new revenue recognition model would replace accounting standards on revenue that were introduced in 1993 and have remained largely unchanged since then. In a US GAAP context, this single model would replace more detailed guidance whereby many entities follow approaches that are specific to their industry or types of transactions.

The central proposal is that entities would identify the performance obligations contained within contracts with customers and recognise revenue as those performance obligations are satisfied by transferring goods and services to customers. The overall focus on the systematic identification and pricing of performance obligations is likely to feel familiar to most technology companies. However, the proposed guidance on identifying and pricing separate performance obligations in bundled arrangements is more detailed and prescriptive than that under current IFRSs, resulting in differences from current practice.

A key area for technology companies considering the proposals will be the withdrawal of the percentage of completion method used to recognise revenue when producing assets specified by customers. A similar revenue recognition outcome may arise provided that the transfer of control is on a continuous basis. Further, technology companies will have to evaluate the terms of a licence in order to determine whether the contract provides for a transfer of control over intellectual property, or provides for an exclusive or non-exclusive licence. Revenue recognition will vary significantly depending upon the type of licence or right to use. Other areas of particular significance to technology companies in the ED include the accounting for bundled transactions and onerous contracts.

It will be important that constituents assess whether this guidance is sufficiently robust and operational, and reflects fairly the wide range of business models to which it would need to be applied.

We hope that this publication will assist you in gaining a greater understanding of the proposals in ED/2010/6. We encourage you to join in the debate and to provide the IASB with your comments by the deadline of 22 October 2010.

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About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

We would like to acknowledge the efforts of the principal authors of this publication, which has been developed from our cross-industry publication *New on the Horizon: Revenue from contracts with customers*. The authors of the cross-industry publication included Emmanuel Lahouste, Astrid Montagnier, Brian O'Donovan and Hirotaka Tanaka of the KPMG International Standards Group. The authors of this industry-based publication include Phil Dowad, Aditya Maheshwari and Julie Santoro of the KPMG International Standards Group, and Brian Allen of KPMG in the US.

Content

Our *New on the Horizon* publications are prepared upon the release of a new proposed IFRS or proposed amendment(s) to the requirements of existing IFRSs. They include a discussion of the key elements of the new proposals and highlight areas that may result in a change of practice.

This edition of *New on the Horizon* considers the proposed requirements of ED/2010/6 *Revenue from Contracts with Customers* (the ED), published by the IASB and the FASB on 24 June 2010, with additional focus on the potential impact of the proposals on companies in the technology sector.

The text of this publication is referenced to the ED and to selected other current IFRSs in issue at 30 June 2010. References in the left-hand margin identify the relevant paragraphs.

Further analysis and interpretation will be needed in order for an entity to consider the potential impact of this ED in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group, and these observations may change.

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1. Executive summary

- ED/2010/6 *Revenue from Contracts with Customers* (the ED) is part of the IASB and the FASB's (together, the Boards) project to introduce an improved and converged global standard on revenue recognition.
- The ED proposes a principles-based model under which an entity recognises revenue as it satisfies the performance obligations included in contracts with customers.
- Under the ED, contracts with customers may be written, oral or implied but must have commercial substance and be enforceable. Two or more contracts would be combined and therefore accounted for together if their prices are interdependent; conversely, a single contract would be segmented if goods or services are priced independently.
- Within each identified contract, an entity would identify performance obligations, or enforceable promises to transfer goods or services to a customer. Performance obligations would be accounted for separately to the extent that they are "distinct" and are satisfied at different times.
- Entities would allocate the transaction price to separate performance obligations on the basis of the relative stand-alone selling prices of the performance obligations. The transaction price would be the amount of consideration that an entity expects to receive from a customer to satisfy the performance obligations.
- An entity would reflect variable consideration in the transaction price only to the extent that it can be reasonably estimated by reference to relevant experience. If an entity cannot reasonably estimate variable consideration, then the entity does not include that part of the total consideration in the transaction price and does not recognise it until it can be reasonably estimated.
- The allocated transaction price would be recognised as revenue as the related performance obligation is satisfied, i.e. when control of the promised goods or services is transferred to the customer. Transfer of control may occur at a point in time or on a continuous basis.
- Indicators as to when control passes to the customer would include that the customer has an unconditional obligation to pay cash, the customer has physical possession and the customer has legal title. Another indicator would be that the design or function of the goods or services is customer-specific.
- If the costs of fulfilling a contract are not eligible for capitalisation under other IFRSs (e.g. IAS 2 *Inventories*), then a separate asset would be recognised only if the costs relate directly to future performance under a contract and are expected to be recovered. Otherwise, costs would be recognised as an expense when incurred.
- A contract loss would be recognised in respect of performance obligations that are deemed onerous, i.e. when performance obligations for which the costs of satisfying the obligation exceed the allocated transaction price. Such a loss would be recognised first as an impairment loss against any related asset (e.g. inventory) and then as a separate liability for the onerous performance obligation.

- A contract asset or contract liability with a customer (i.e. the net asset or liability arising from the remaining rights and obligations in a contract) would be presented when the entity performs by transferring goods or services, or the customer performs by paying consideration to the entity.
- The ED includes application guidance on issues such as product return rights, product warranties, licensing, agent vs principal, sale and repurchase arrangements, consignment arrangements, and bill-and-hold arrangements.
- The ED proposes a range of quantitative and qualitative disclosures intended to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.
- The ED proposes that the new standard would be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- The ED does not propose an effective date for the new standard since the Boards plan an additional consultation on the effective date of this and other new standards.
- The IASB proposes that first-time adopters of IFRSs be permitted to adopt the new standard early but has not determined whether existing users of IFRSs could adopt the new standard early.

2. Key impacts

Key focus areas for technology companies when assessing the impact of the ED include the following:

- **Identification of contracts (see section 5.1):** The ED's proposed approach to combining and segmenting contracts is similar but not identical to that in IAS 11 *Construction Contracts*.
- **Identification of separate performance obligations (see section 5.2):** The ED proposes a systematic approach to the identification of performance obligations to be applied to all contracts within scope. This may accelerate or defer reported revenue compared to existing practice to the extent that the separate performance obligations identified under this approach differ from the components accounted for separately under current IFRSs.
- **Determining the transaction price (see section 5.3):** The ED proposes that an entity include variable consideration in the transaction price from the time that it can be reasonably estimated. This may accelerate reported revenues for entities that currently apply a higher threshold before recognising variable consideration as revenue. In addition, the ED includes specific guidance on evaluating collectibility and the effect of the time value of money that may affect the amounts recognised as revenue.
- **Allocating the transaction price to separate performance obligations (see section 5.4):** The ED proposes that an entity allocate the transaction price to separate performance obligations by reference to the relative stand-alone selling prices of goods or services. Generally, a change from the residual method to the approach proposed in the ED would have the effect of accelerating reported revenues. However, a residual or reverse residual method can be used to estimate stand-alone selling prices, and in certain circumstances could result in accounting outcomes that are comparable to the residual or reverse residual method.
- **Withdrawal of percentage of completion method (see section 5.5):** The ED proposes the withdrawal of the IAS 11 approach under which technology companies such as IT consulting, and software and services companies use the percentage of completion or proportional performance methods to recognise revenue throughout the contract term for long-term contracts, such as the development of software products or IT solutions as specified by customers. A similar revenue recognition outcome may arise under the ED if control of the software product or IT solution being developed is transferred to the customer continuously; if this is not the case, then entities may be required to defer revenue until development is complete and control passes. The assessment of whether control transfers on a continuous basis or at one point in time will be one of the most critical judgements to be made by technology companies in applying the proposals in the ED.

The ED does not envisage that revenue relating to a satisfied performance obligation should be limited to the amount that is not dependent/contingent upon the performance of future obligations under the contract. This may result in a significant change from current practice for some technology companies.

Further, the proposals in the ED relating to customer acceptance are more detailed than the current requirements in IAS 18 *Revenue*.

- **Accounting for contract costs (see section 5.6):** The ED proposes that the costs of obtaining a contract, such as commission paid to internal sales personnel or external sales agents, be recognised as an expense when incurred. However, it is unclear whether the final standard would be the only applicable standard for accounting for such costs.

- **Onerous performance obligations (see section 5.7):** The ED proposes that entities evaluate whether separate performance obligations are onerous. This could result in the recognition of losses for performance obligations even if the overall contract is expected to be profitable. However, the ED does not discuss the potential interaction between the transaction price model and onerous performance obligations, and it is not entirely clear that the Boards' intention is that an onerous performance obligation could arise at inception.
- **Other specific applications (see section 6):** The ED includes application guidance that would form part of the proposed standard, on topics such as sales with a right of return, warranties, customer incentives, licensing arrangements, bill-and-hold arrangements, agent vs principal and consignment arrangements, which could differ from current, and sometimes varied, practice. Key changes under the proposals for warranties and licences include:

Warranties. The proposals in the ED distinguish between accounting for faults post-delivery, or extended warranties, and cover for latent defects. While the former results in deferral of a portion of revenue in all cases, the latter would result in deferral of a portion of revenue only when some of the products transferred are expected to be defective.

Licences or right to use. Technology companies will have to evaluate the terms of a licence or right to use contract in order to determine whether the contract provides for a transfer of control, or provides for an exclusive or non-exclusive right to use asset. Revenue recognition will vary significantly depending upon the type of licence or right to use. Revenues with respect to non-exclusive licences/rights, which is the case for typical term-based software licences, as well as perpetual licences, would be recognised when the customer is able to use and benefit from rights (i.e. at the beginning of the licence period).

- **Additional disclosure requirements (see section 8):** The proposed disclosures are more extensive and detailed than the current requirements in IAS 18 and IAS 11.
- **Increased use of judgement and estimates:** Generally, application of the ED would require greater use of judgement. This would in turn require practical interpretation of proposed new criteria and thresholds ("distinct", "reasonable estimate", etc).

3. Introduction and background

The objective of the Boards' joint project on revenue is to provide a single, principles-based revenue recognition standard for use across various industries and capital markets. The project is included in the Memorandum of Understanding issued by the Boards in 2006 and updated in 2008.

The Boards published a Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers* (the DP) in December 2008. In the DP the Boards proposed a contract-based model in which revenue would be recognised on the basis of changes in an entity's net position in a contract with a customer. The DP presented the Boards' preliminary views on the proposed model but did not include all the guidance necessary to implement the model.

Since publishing the DP, the Boards have developed the model more fully and have received extensive input from constituents through comments letters on the DP, workshops and other consultations.

With the ED, the Boards have now published a proposed new standard, including application guidance that would form an integral part of the new standard. The new standard is intended to replace IAS 11, IAS 18, IFRIC 13 *Customer Loyalty Programmes*, IFRIC 15 *Agreements for the Construction of Real Estate*, IFRIC 18 *Transfers of Assets from Customers* and SIC-31 *Revenue – Barter Transactions Involving Advertising Services*.

The comment deadline for the ED is 22 October 2010. The Boards plan to hold public round-table meetings after the end of the comment period and to issue the new standard by June 2011. The Boards plan an additional consultation on the effective date of this and other new standards.

4. Scope

4.1 Scope of the proposals

ED 1, BC9

The ED defines revenue as income arising in the course of an entity's ordinary activities.

Under the *Framework for the Preparation and Presentation of Financial Statements*, revenue includes revenue arising from contracts with customers and revenue arising from other transactions or events. The proposals in the ED would apply only to one category of revenue: revenue from *contracts with customers*. Other forms of revenue would continue to be dealt with under other IFRSs.

ED App A

A contract is an agreement between two or more parties that creates enforceable rights and obligations (see section 5.1). A customer is defined as a party that has contracted with an entity to obtain goods or services that are an *output of the entity's ordinary activities*.

IAS 18.1

Observations

IAS 18 applies to revenue arising from the sale of goods, rendering of services and the use by others of an entity's assets yielding interest, royalties and dividends.

ED BC10

Dividends received and revenues from non-contractual royalties that are currently in the scope of IAS 18 would be outside the scope of the new standard. Although the Basis for Conclusions of the ED states that revenue that does not arise from a contract with a customer would not be affected by the proposals, it is not always clear which standard would apply to such transactions.

The introduction of definitions of a contract and a customer reflects the focus of the proposed revenue recognition model. IAS 18 does not define these terms and IFRSs have not previously sought to define customer.

ED BC13

The term contract is defined in IAS 32 *Financial Instruments: Presentation*. The definition of a contract in the ED is not exactly the same as the definition of a contract in IAS 32, stopping short of requiring that a contract be enforceable by law. The IASB does not propose to amend the definition of a contract in IAS 32, on the grounds that this may have unintended consequences. As a result, there could be two existing definitions of a contract in IFRSs, one in the new revenue standard and another in IAS 32.

4.2 Scope exceptions

ED 6

The new standard would apply to all contracts with customers except:

- lease contracts in the scope of IAS 17 *Leases*;
- insurance contracts in the scope of IFRS 4 *Insurance Contracts*;
- contractual rights or obligations in the scope of IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*; and
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange.

IAS 18.12

Observations

At first glance, there appear to be some differences between the lists of specific scope exceptions in the ED and in IAS 18. However, some apparent differences can be reconciled if the scope exclusions are read in conjunction with the definitions. For example, non-monetary exchanges between entities in the same line of business to facilitate sales to customers that are excluded explicitly from the scope of the ED also are not regarded by IAS 18 as transactions generating revenue.

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

ED BC252,
App C

Sales of assets that are not an output of the entity's ordinary activities are outside of the scope of the ED. However, the recognition and measurement principles of the ED apply to contracts for the sale of the following assets that are not an output of the entity's ordinary activities:

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

The ED proposes consequential amendments to these standards to align their derecognition requirements with those in the ED. Consequently, on transfer of control of such an asset the entity would:

- derecognise the asset; and
- recognise a gain or loss for the difference between the transaction price and the carrying amount of the asset.

Observations

The requirements of IAS 16, IAS 38 and IAS 40 are that assets are derecognised when the entity meets the conditions to recognise a sale of goods under IAS 18. The timing of recognition and the measurement of gains or losses on sales of such assets could be affected by the ED in a similar way to sales arising from contracts in the entity's ordinary activities.

The ED does not state explicitly that these classes of assets also may be derecognised in a sale and leaseback transaction, in which case the entity currently applies the requirements of IAS 17 to the transaction. It will be important that the Boards clarify the requirements that will apply in the future to such transactions given the Boards' intention to introduce a new accounting model for lease accounting.

4.4 Sale and repurchase of an asset

ED B47

If an entity sells an asset to a customer and agrees to repurchase that asset (or an asset that is substantially the same, or an asset of which the sold asset is a component) in the future, the entity would consider whether the contract is in the scope of the ED.

ED B48

Repurchase agreements can be:

- a customer's unconditional right to require the entity to repurchase the asset (a put option);
- an entity's unconditional obligation to repurchase the asset (a forward); and
- an entity's unconditional right to repurchase the asset (a call option).

ED B52 If a *customer* has a put option, then the customer has control of the asset. In such a case, the contract would be in the scope of the ED and the entity would account for the agreement similarly to the sale of a product with a right of return (see section 6.1).

ED B49-B51 Conversely, if the *entity* has a forward or a call option, then the customer would not obtain control of the asset, and the contract would not be in the scope of the ED. In such a case, the entity would account for the sale and repurchase agreement as:

- a right of use in accordance with IAS 17 if the entity repurchases the asset for an amount that is less than the original sales price of the asset (i.e. in effect the customer pays a net amount of consideration to the entity). The asset would not be derecognised and the difference between consideration paid and consideration received would be a lease payment; or
- a financing arrangement if the entity repurchases the asset for an amount that is equal to or more than the original sales price of the asset (i.e. the entity pays a net amount of consideration to the customer). The asset would not be derecognised and the difference between consideration paid and consideration received would be interest and, if applicable, holding costs.

Observations

IAS 18.IE5

Sale and repurchase agreements are currently in the scope of IAS 18 unless they relate to sales and purchases of financial assets.

The requirements in the ED regarding sales and repurchases of assets are more detailed than in IAS 18. The proposed approach reflects the change from a risks and rewards approach to revenue recognition under IAS 18 to a transfer of control approach under the ED (see 5.5.1). The current accounting treatment of sale and repurchase agreements under IAS 18 is further discussed in our publication *Insights into IFRS* (4.2.170).

4.5 Contracts partially in the scope of the ED

ED 7, BC22-BC24

A contract can be partially in the scope of the ED and partially in the scope of other IFRSs, for example a contract to lease an asset to a customer (within the scope of IAS 17) and to deliver maintenance services on the leased asset (within the scope of the ED). In such a case, the entity considers whether the IFRS that relates to the part of the contract that is not within the scope of the ED includes specific guidance on the separation and measurement of contracts:

- if the other IFRS includes guidance on separation and/or measurement, then the entity first applies that guidance; or
- if the other IFRS does not include guidance on separation and/or measurement, then the entity applies the guidance in the ED.

Observations

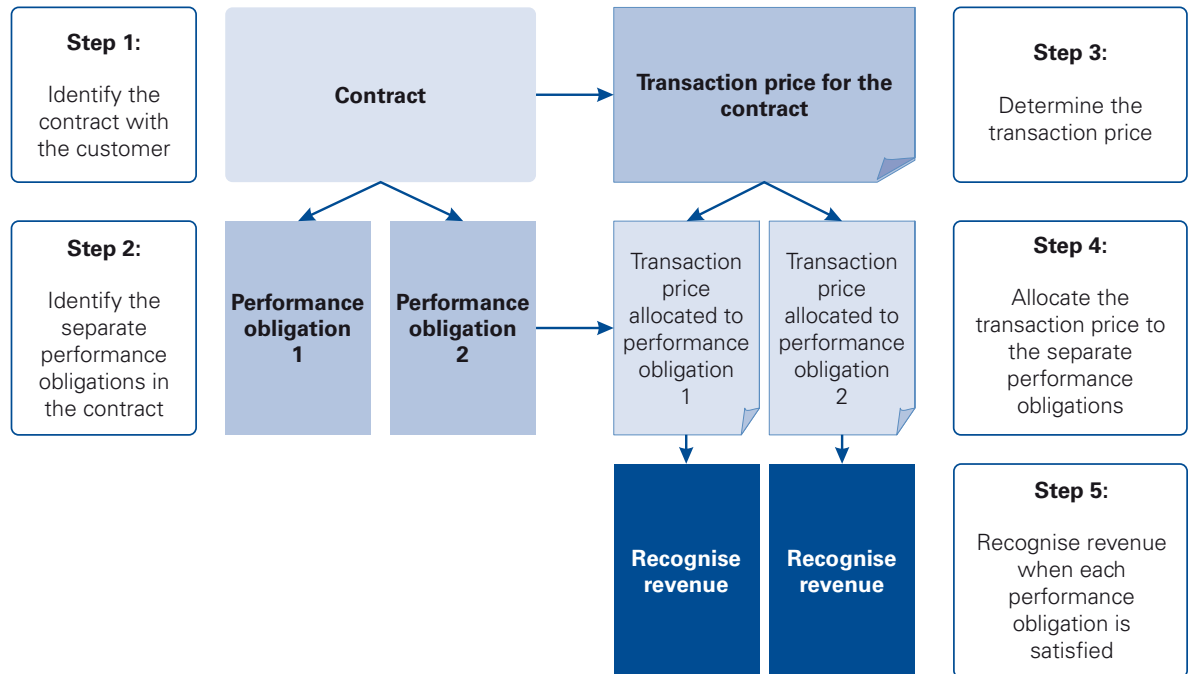
There is no equivalent hierarchy within IAS 11 and IAS 18 addressing the separation and measurement of contracts that are partially within the scope of another standard, though some other IFRSs do include such guidance. For example, if an arrangement contains a lease and other services, then IFRIC 4 *Determining whether an Arrangement contains a Lease* requires both the lessor/seller and the lessee/buyer to separate the consideration between the lease and non-lease elements of the arrangement by reference to their relative fair values.

One practical consequence of the proposed hierarchy is that if a contract is partially within the scope of the ED and partially within the scope of another IFRS, then the measurement of revenue may depend on the requirements of the other IFRS. It is difficult to assess the significance of this possibility at present, given that the Boards have active projects on, for example, insurance contracts and lease accounting.

5. A new model for revenue recognition

ED 2

The ED describes a five-step model for revenue recognition:



These five steps are discussed in sections 5.1 to 5.5. The ED also specifies the accounting for some costs, as described in section 5.6. Additional guidance on changes that may occur after contract inception, i.e. contract modifications and performance obligations becoming onerous, is discussed in section 5.7.

5.1 Step 1: Identify the contract with the customer

5.1.1 When to apply the model to a contract

ED 9

A contract need not be written but may be oral or implied by the entity's customary business practice. An entity would consider the practices and processes for establishing contracts with customers to determine whether a contract exists. These practices and processes may vary across jurisdictions and industries, and may be different for different classes of customers or goods or services.

ED 10

A contract exists for the purpose of applying the requirements in the ED only if:

- the contract has commercial substance (i.e. the entity's future cash flows are expected to change as a result of the contract);
- the parties to the contract have approved the contract and are committed to satisfying their respective obligations;
- the entity can identify each party's enforceable rights regarding the goods or services to be transferred; and
- the entity can identify the terms and manner of payment for those goods or services.

ED 11

A contract would not exist for the purpose of applying the ED if:

- it is a wholly-unperformed contract, i.e. the entity has not transferred goods or services and the customer has not paid any consideration; and
- either party can terminate the contract without penalty.

Observations

ED B61

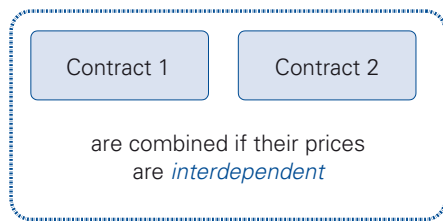
Identifying whether a contract exists also will be important in determining whether it is acceptable to recognise revenue on a bill-and-hold basis. In such circumstances establishing that the customer is committed to satisfying its obligations may be very judgemental, especially when payment is deferred (see section 6.5).

5.1.2 Combining and segmenting contracts

ED 12-15

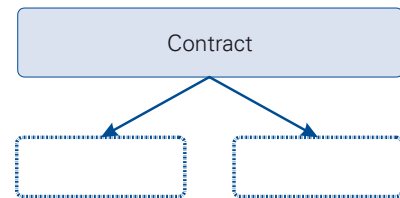
In most cases, the entity would apply the requirements of the ED to a single contract with a customer.

However, in some cases the entity may be required to combine or segment contracts to apply the requirements of the ED. Two or more contracts would be combined and therefore accounted for together if their prices are interdependent; conversely, a single contract would be segmented if goods and services are priced independently, as illustrated below:



Indicators that contracts have interdependent prices include:

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



Goods or services are priced independently if:

- the entity or another entity regularly sells identical or similar goods or services separately; and
- the customer does not receive a significant discount for buying some goods or services together with other goods or services in the contract.

ED 16

The ED proposes that if an entity segments a contract, then the entity allocates the total contract consideration to contract segments in proportion to the relative stand-alone selling prices of the goods or services included in each contract segment.

Illustrative example – Combining and segmenting contracts

Scenario 1 – Segmenting contracts

Company B enters into a contract with Customer Z to sell specialised digital equipment and 12 months maintenance services (extended maintenance) for a total consideration of 400. B sells the specialised digital equipment without the extended maintenance services for 375 to other customers. Other vendors offer similar maintenance services for 30 per year.

In order to assess whether to segment the contract for the purposes of applying the ED, B considers first whether it or other entities regularly sells similar items on a stand-alone basis; this appears to be the case. Secondly, B considers whether Z receives a significant discount for buying the items together; the discount is 1.25 percent, which does not appear to be significant.

B concludes that since (1) the equipment is sold regularly on a stand-alone basis without the extended maintenance services; (2) other vendors sell similar maintenance services; and (3) Z does not obtain a significant discount for buying the digital equipment and extended maintenance services together, the equipment and maintenance services can be viewed as “priced independently” and accordingly it should segment the contract.

Scenario 2 – Combining contracts

Company C, a software vendor, enters into a contract with Hospital X for the sale of 1,200 identical heart monitors that will be shipped over a period of time, bundled with a customised software solution and server that allows for the data from the heart monitors to be uploaded and read at a central location; each monitor and the related software solution and server is referred to as a “unit”. C does not sell the monitor separately from the customised software and server. C generally sells these units to customers for 15,000. C also specialises in providing support services for cardiological equipment.

Around the same time, C’s services department is in the process of negotiating the annual support contract with X for the following year. C estimates that the support contract will be worth approximately five million, and therefore decides to substantially discount the sales price of the 1,200 units by 30 percent. Two weeks later, it enters into a separate contract with X for the annual support of all its cardiological equipment for 4.5 million.

In this example it would appear that C should combine the two contracts, i.e. the contract for selling 1,200 units as well as the annual maintenance of the cardiological devices, since their prices are interdependent and the two contracts though separate were entered into at around the same time.

Observations

At first glance, the ED’s proposals on segmenting and combining contracts may seem superfluous, given that an entity breaks down a contract into separate performance obligations in Step 2 and much of the subsequent analysis treats the performance obligation as the unit of account, not the contract. However, identification of the contract is important in some circumstances, for example if a change in the estimated amount of variable consideration is allocated to all performance obligations within a contract (see 5.7.2); or when contracts that should be combined are executed in different accounting periods.

IAS 11.8, 9

IAS 11 contains explicit guidance on combining and segmenting construction contracts, which is sometimes applied by analogy to other contracts in order to identify different components under current IFRSs. This is discussed in our publication *Insights into IFRS* (4.2.50). In contrast, the ED’s proposals on combining and segmenting contracts would be applied to all contracts within its scope, as the first step in applying the proposed revenue recognition model.

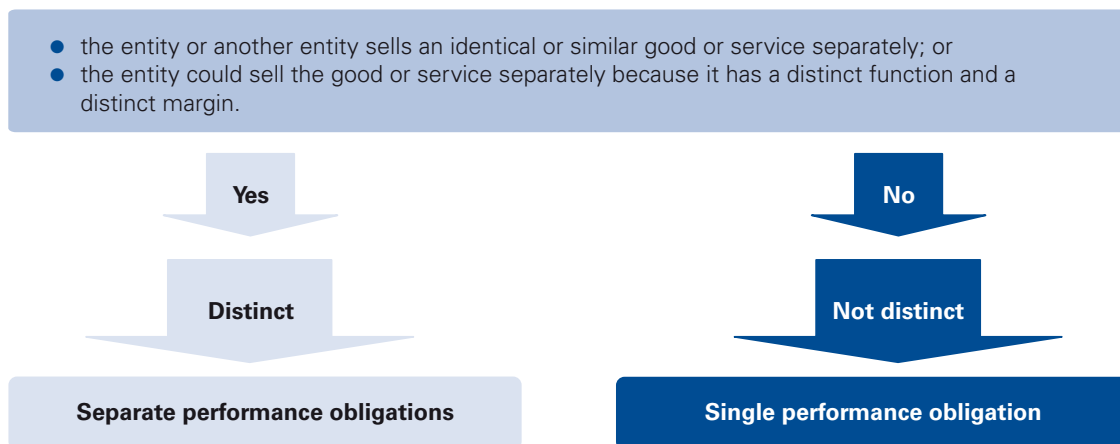
The ED’s proposed approach to combining and segmenting contracts is similar but not identical to that in IAS 11, and at first glance the conclusions reached by applying current accounting practice are not expected to change. However, minor differences will have to be evaluated as these may result in different outcomes under the ED than under current practice. For example, the combination criteria in IAS 11 require the contracts to be part of a single project with an overall profit margin but do not require the contracts to be entered into at or near the same time.

5.2 Step 2: Identify the separate performance obligations in the contract

5.2.1 Criteria to identify separate performance obligations

ED 20, App A The next step in applying the model is to identify the separate performance obligations in each contract. A performance obligation is an enforceable promise to transfer a good or service, and may be stated explicitly in the contract or may be implicit.

ED 20-23 To do this, the entity considers whether the promised goods or services are “distinct,” as follows:



ED 23 A good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from the entity or is sold separately by the entity or by another entity. It has a distinct profit margin if it is subject to distinct risks and if the entity can identify separately the resources needed to provide the good or service.

ED 24 Theoretically, some contracts could be broken down into a very large number of performance obligations. However, if the entity transfers promised goods or services at the same time, then it would not be necessary to apply the recognition and measurement requirements of the ED to each separate performance obligation if accounting for the performance obligations together results in the same outcome.

Illustrative example – Identify separate performance obligations

Scenario 1 – Initial set-up service is not a separate performance obligation

Cloud Service Provider (CSP) C enters into an agreement with Customer X that is valid for three years. Under the agreement, X pays a lump-sum amount of 600,000 for the following products and services:

- (1) Initial set-up services to customise, configure and install the cloud service prior to service commencement.
- (2) 1,000 hours of ongoing other professional services that are not essential to the initial service commencement (i.e. ongoing configuration, data migration and support). Any hours beyond the contracted 1,000 hours will be invoiced at 150 per hour. C routinely charges other customers on a time and materials basis at 150 per hour when such professional services are sold separately.
- (3) Non-cancellable one-year access to the cloud services. These cloud services are renewable at the customer’s option at 500,000 per year for each of the remaining two contract years.

X's ability to use the cloud service's functionality is not possible until the set-up services are completed. The set-up services performed are not portable to another CSP's service offering and no other parties can provide set-up services for C's cloud offerings.

C routinely sells the one-year access to cloud services to other customers for 500,000 per year on an initial annual term or renewal-term basis; C does not charge customers for initial set-up services as an incentive to sign up to the first year of the cloud service. Further, other CSPs routinely provide similar cloud services on a stand-alone basis.

The initial set-up services on their own do not transfer any goods or services to the customer and are not considered distinct services. Further, C and other CSPs provide initial set-up services only when there is an agreement to provide ongoing cloud services. Initial set-up services provided by a CSP are not portable to another CSP's cloud service offerings.

Accordingly, C has assessed that it has two performance obligations: the other professional services for 1,000 hours; and the ongoing cloud services for a one-year term, which includes the initial set-up services. These services are considered distinct from one another as they are sold separately by C. The other professional services are provided to other customers who do not subscribe to C's cloud services. C has established a stand-alone selling price of 150 per hour for these services and accordingly the profit margin can be determined easily. C provides customers the ongoing cloud services at a renewal rate of 500,000 each year and these are sold separately from other services. Therefore, C's assessment that the arrangement has two performance obligations is appropriate under the proposals.

Scenario 2 – Upgrade right is a separate performance obligation

In August 2010 Company B enters into a contract with Customer C to deliver off-the-shelf payroll software Version 2.0, and to provide telephone support service for one year for a non-refundable fee of 100,000. C can renew the telephone support service at the end of the first year based on the then existing price list. B generally sells the payroll software bundled with the first year of telephone support to new customers. Other vendors sell similar payroll software with some minor differences. As C is aware that B has plans to release Version 2.1 of the payroll software in the near term, B also promises that C will receive Version 2.1 when it is released at no additional charge.

Management has established the price to be charged to existing users of Version 2.0 to upgrade to Version 2.1.

B has determined that it has three separate performance obligations: the payroll software Version 2.0; one-year telephone support; and the upgrade right to Version 2.1, based on the following analysis:

- *Software Version 2.0.* Although B generally sells the software along with the first year of telephone support services, it is off-the-shelf software and there is evidence that other vendors sell similar software with minor differences. B could sell it separately and determine its separate profit margin. Further, the software has utility on its own as compared to the telephone support services and the upgrade right, and therefore is considered distinct from the other performance obligations in the contract.
- *Telephone support service.* B provides telephone support services on a stand-alone basis to existing customers and therefore telephone support is considered a distinct performance obligation.

- *Upgrade right Version 2.1.* The upgrade right has a distinct function and a distinct profit margin:
 - *Distinct function.* Since Version 2.1 is an “upgrade”, it is expected to have features and functionalities separate from the existing software, and therefore is considered to have a distinct function as compared to the telephone support services and Version 2.0.
 - *Distinct profit margin.* Although Version 2.1 has not been developed yet, B intends to sell it separately to existing customers based on the price already determined by management. Further, since Version 2.1 has distinct risk when compared to the other performance obligations in the contract, and as long as management can identify the resources required to produce and deliver Version 2.1, it would meet the criteria of a separate performance obligation.

IAS 18.13

Observations

IAS 18 requires entities to consider whether a transaction contains “separately identifiable components” and there is guidance on the identification of components in specific circumstances in IFRIC 13, IFRIC 15 and IFRIC 18. However, there is no comprehensive guidance in current IFRSs on identifying separate components that applies to all revenue-generating transactions. Current approaches in this area are discussed in our publication *Insights into IFRS* (4.2.50.60).

In contrast, the ED proposes a systematic approach that would be applied to all contracts within the scope of the new standard, and that each of the IFRICs noted above be withdrawn.

Further, in order to assess the potential impact of the proposals on their reported revenues, technology companies that enter into bundled transactions with customers would need to evaluate the extent to which the components they account for separately under current IFRSs differ from the separate performance obligations that would be identified under the ED.

5.2.2 Non-refundable upfront fees

ED B27, B28

The ED’s approach to the identification of separate performance obligations would also drive the accounting treatment of non-refundable fees that an entity charges its customers at or near contract inception.

ED B28

The ED states that in many cases such an upfront fee is not a separate performance obligation: it does not relate to an activity that results in the transfer of goods or services to the customer but is rather an advance payment for future goods or services.

Illustrative example – Non-refundable upfront fees

Company E operates an electronic payment processing service on behalf of retailers who accept payments by credit card. One-off costs are incurred by Company E at inception of the arrangement, in adding the retailer to its processing system.

Charges to retailers for the service comprise a set-up fee on inception of the arrangement followed by annual charges payable in one single instalment in advance.

E’s activities relating to adding the retailers in its processing system do not transfer any service to the customer and therefore are not a performance obligation. The promised service under the contract is the electronic payment processing system. Accordingly, the set-up fee is included in the transaction price allocated to the performance obligation to provide electronic

payment during one year and to the option to renew. Consequently, the non-refundable set-up fee is recognised as revenue over the period that E expects to provide services to the customer.

E will consider capitalisation of the one-off costs in accordance with paragraph 57 of the ED (see section 5.6).

Observations

The proposed approach to non-refundable upfront fees would result in changes in current practice in some areas.

IAS 18.IE17,
IE18

IAS 18 includes an illustrative example in which an entity recognises initiation, entrance and membership fees as revenue provided that there is no significant uncertainty as to collection of the fee, the entity has no further obligation to perform any continuing services for that fee and other or additional services are paid for separately. In this example, the focus is on whether the fees for the continuing services cover their cost, not on whether the entity has delivered upfront services. In contrast, the ED includes an example in which a health club charges a non-refundable joining fee for the initial activity of registering a customer. It concludes that the health club should defer recognition of the fee as revenue as it does not transfer a service to the customer at inception of the arrangement.

5.3 Step 3: Determine the transaction price

ED 34, App A

The next step in applying the model is to determine the transaction price for the contract, that is, the probability-weighted amount of consideration that an entity receives or expects to receive from the customer in exchange for transferring goods or services.

ED 42

Factors to consider when determining the transaction price include:

- estimates of any variable consideration (see 5.3.1);
- the effect of the customer's credit risk (see 5.3.2);
- the effect of the time value of money if a contract includes a material financing component (see 5.3.3);
- the fair value of non-cash consideration (see 5.3.4); and
- whether a certain amount of consideration payable to the customer is a discount or a payment (see 5.3.5).

5.3.1 Estimating the transaction price when consideration is variable

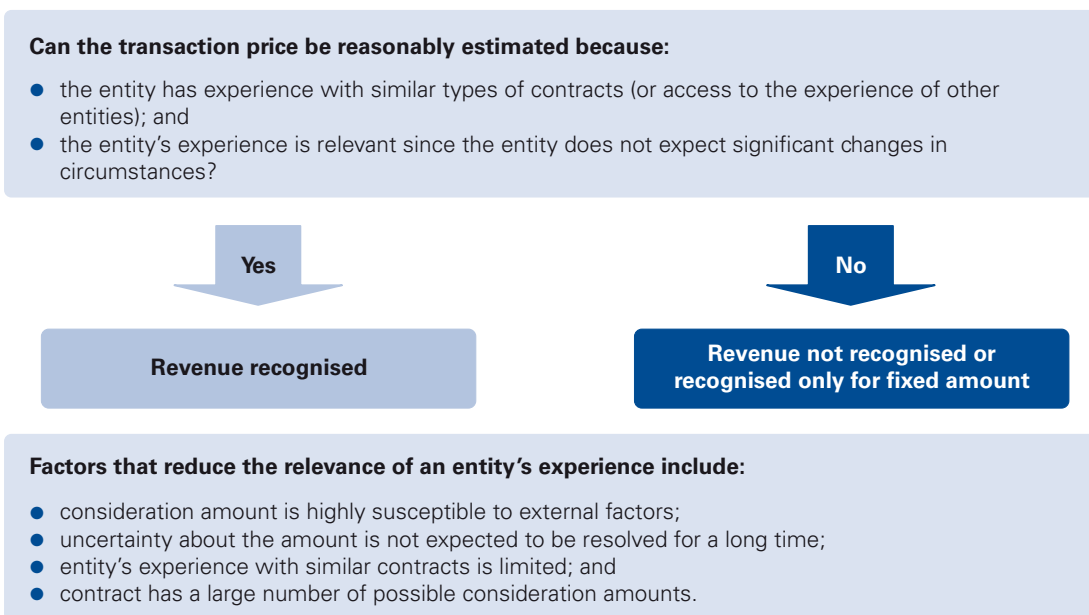
ED 35, 36

If the consideration payable by a customer is variable, then the entity estimates the transaction price each reporting period. Consideration may be variable due to discounts, rebates, performance incentives, contingencies, refunds, or other similar items.

ED 38-41

If an entity cannot reasonably estimate part of the total consideration, then the entity does not include that part of the total consideration in the transaction price and does not recognise it as revenue until it can be reasonably estimated. In the meantime, the transaction price and revenue recognised include only amounts that can be reasonably estimated.

ED 38 An entity determines if the transaction price is reasonably estimated by considering the following two questions:



Illustrative example – Estimating the transaction price when consideration is variable

On the sale of licensed software, Company S offers customers the option to purchase a 12-month after-sales support programme. Included in these yearly support contracts are service level agreements (SLA) that provide customers with agreed upon performance expectations/ obligations, along with certain metrics. These metrics have monetary and contractual implications if agreed upon levels of performance are not achieved in the form of refunds or reduction of the fees owing as follows:

SLAs	Reduction in fees
Faults not rectified within 5 business days	10%
Fault not rectified within 10 business days	25%
Fault not rectified within 30 business days	50%

The monthly support fees are 10,000 per customer. S has made no significant changes to the functionality of the software and no new features have been added to it. Further, S expects the requests received during the support period to be routine in nature. Based on this, S determines the following probabilities:

Possible outcomes	Probabilities	Expected fees
All faults rectified within 5 business days	80%	8,000 (10,000 x 80%)
Faults not rectified within 5 business days	10%	900 (10,000 x 90% x 10%)
Faults not rectified within 10 business days	10%	750 (10,000 x 75% x 10%)
Faults not rectified within 30 business days	0%	Nil
Total	100%	9,650

S determines that the transaction price based on a probability-weighted average can be estimated reasonably. This is because:

- S has past experience with similar contracts with other customers;
- S is able to estimate reasonably that it does not expect a significant change in the types of requests received from the customers during the support period;
- S expects all faults to be resolved in a relatively short period of time, i.e. within 10 days of the date of occurring; and
- there is a relatively low number of possible outcomes of the monthly consideration.

Accordingly, S assesses the monthly transaction price to be 9,650.

Note: The time value of money and customer credit risk have been ignored for the purpose of this example.

Observations

At first glance, the proposal is expected to change the current accounting practices for some technology companies, whereby management would be required to make significant judgements regarding probability assessments and arrive at predictive values in contracts with variable consideration.

IAS 18.14, 26

IAS 18 requires that an entity recognise revenue only if it can estimate the amount of revenue reliably. In addition, if the variability in the consideration provides evidence that the seller has not transferred the risks and rewards of ownership of the goods sold, then the entity may be required to defer revenue even if it can estimate the amount of consideration reliably. In the case of rendering services, if the outcome of the transaction is not reliably measurable, then revenue is recognised only to the extent of the expenses recognised that are recoverable. In contrast, the ED requires only that an entity can make a reasonable estimate of the amount of consideration; if an entity can reasonably estimate only a portion of the consideration, then it may still recognise revenue in respect of that portion provided that control over the goods or services has transferred to the customer.

The ED does not comment on whether its test of whether consideration can be “reasonably estimated” is intended to be a higher or lower threshold than IAS 18’s current test of whether revenue can be “measured reliably”.

5.3.2 Collectibility

ED 43, B79

The ED requires an entity to assess collectibility, i.e. the customer’s ability to pay the promised consideration, when determining the transaction price. This includes situations in which an entity enters into contracts with customers and expects a proportion of them to default, but does not know which specific customers will default.

ED 43

At inception of an arrangement, the entity would adjust the amount of consideration to reflect the customer’s credit risk to a probability-weighted expected amount. Subsequently, when the entity has an unconditional right to receive consideration from the customer, the entity would recognise the effects of subsequent changes in the customer’s credit risk (whether increases or decreases) separately from revenue.

ED B79

Illustrative example – Customer credit risk

Company S enters into a contract with a customer to provide data migration services for a total consideration of 20,000. Payment is due one month after the services have been provided. Based on its experience, S assesses that there is a 5 percent chance that the customer will not pay the consideration.

Initial measurement

The transaction price is 19,000 ($(95\% \times 20,000) + (5\% \times 0)$). S recognises revenue of 19,000 as it provides services to the customer and satisfies its performance obligation.

Subsequent change

S determines that the receivable due from the customer is impaired by 400 because of further deterioration in the customer's financial condition. S recognises the additional impairment as an expense rather than as a reduction in revenue. Conversely, if the customer's financial condition improves and S collects more than the original 19,000, then the excess is recognised in another component of income rather than as revenue.

IAS 18.18

Observations

One of the criteria for recognising revenue under IAS 18 is that it should be probable that economic benefits associated with the transaction will flow to the entity. Provided this criterion is met, IAS 18 does not refer explicitly to customer credit risk in the context of measuring revenue, though its general requirement is to measure revenue at the fair value of the consideration received or receivable. In addition, IAS 18 states that if an amount included in revenue subsequently becomes uncollectible, then the entity should recognise an *expense* rather than adjust revenue. However, IAS 18 does not appear to envisage that an entity may collect more than originally expected from a customer or group of customers, and therefore be required to record *income* due to a reduction in the customer's credit risk. It is possible therefore that the ED's proposals will result in a more systematic approach to credit risk and a change in practice for technology companies.

5.3.3 Time value of money

ED 44, 45

The ED proposes that an entity adjust the amount of consideration to reflect the time value of money if the contract includes a material financing component. This could be the case if the entity receives payment significantly before or after transferring goods or services. If an entity adjusts revenue in this way, then the entity also would not make the credit risk adjustment discussed above, as the discount rate should reflect both the time value of money and credit risk. The entity would present the effect of the financing component separately from the revenue from other goods or services.

Illustrative example – Time value of money

Software Development Company S enters into a contract with a customer for the development of customised billings management software. S expects the customised software to be delivered at the end of 12 months from the date of entering into the contract and will charge the customer 25,000 for the software with the payment due as follows:

- 10,000 at inception;
- 10,000 on delivery of the software; and
- 5,000 due 12 months after delivery of the software.

The discount rate is 5 percent at inception of the contract.

When S receives the customer's payment of 10,000 at inception, it records the following entry:

	<i>Debit</i>	<i>Credit</i>
Cash	10,000	
Contract liability		10,000
<i>To recognise contract liability</i>		

Over the 12 months until the software is transferred to the customer, S recognises interest expense. S records the following entry:

	<i>Debit</i>	<i>Credit</i>
Interest expense (10,000 x (1.05 - 1))	500	
Contract liability		500
<i>To recognise interest expense</i>		

When S transfers control of the software to the customer, it records the following entry:

	<i>Debit</i>	<i>Credit</i>
Contract liability (10,000 + 500)	10,500	
Cash	10,000	
Accounts receivable (5,000 x (1/1.05))	4,762	
Revenue		25,262
<i>To recognise revenue and record present value of accounts receivable</i>		

At the end of 12 months and on receipt of the last instalment, S records the following entry:

	<i>Debit</i>	<i>Credit</i>
Cash	5,000	
Accounts receivable		4,762
Interest income		238
<i>To recognise receipt of final instalment</i>		

Observations

IAS 18 requires an entity to discount consideration to a present value if payment is deferred and the arrangement effectively constitutes a financing transaction. However, IAS 18 is silent on whether an entity should adjust consideration if payment is received in advance. This issue is discussed in our publication *Insights into IFRS* (4.2.20.60).

The ED's explicit requirement to consider the time value of money whenever there is a material financing component could represent a change in practice for some technology companies. This may be an area of focus for IT consulting and services companies that enter into long-term contracts, whereby the customer pays in advance to enable the technology company to purchase equipment as well as to perform under the contract.

5.3.4 Non-cash consideration

ED 46, 47

The ED proposes that an entity measure non-cash consideration at its fair value. If an entity cannot reasonably estimate the fair value of non-cash consideration, then it would measure the consideration indirectly by reference to the stand-alone selling price of the goods or services transferred.

IAS 18.12
IFRS 2.10,11

Observations

The requirement to measure non-cash consideration at fair value, or at the fair value of the goods or services transferred, is broadly similar to the current requirements of IAS 18 and IFRS 2 *Share-based Payment*. However, under current IFRSs the threshold for using the fair value of the non-cash consideration as the measurement basis is that the entity can “reliably measure” the fair value, not “reasonably estimate”. The ED does not discuss whether these terms are intended to represent materially different thresholds.

The alternative to fall back on the fair value of the goods or services provided if the fair value of the non-cash consideration cannot be reasonably estimated is different from the approach to variable consideration, which is excluded from the transaction price if it cannot be reasonably estimated. It is not clear whether the Boards intend that there should be a lower recognition threshold for transactions in which the entity receives non-cash consideration than for transactions in which the entity receives a variable amount of consideration.

The ED does not otherwise discuss exchanges of non-monetary items, except to note that a non-monetary exchange between entities in the same line of business to facilitate sales to customers other than the parties to the exchange is outside the scope of the ED. IAS 18 includes additional commentary in this area, stating that when goods or services are exchanged for goods or services that are similar in nature and value, the exchange is considered to lack commercial substance and is not treated as a transaction that generates revenue. Moreover, the ED proposes the withdrawal of SIC-31, which includes specific guidance on accounting for barter transactions.

IFRIC 12.
BC30-BC35

IFRIC 12 *Service Concession Arrangements* builds on the discussion of exchanges of non-monetary items in IAS 18 to support the requirement that an operator that receives a right to charge users of service concession infrastructure should recognise revenue in the construction phase of a service concession arrangement. The ED proposes consequential amendments to IFRIC 12 only in order to be consistent with the terminology of the ED, suggesting that no substantive amendments to IFRIC 12 are planned.

5.3.5 Consideration payable to a customer

ED 48

In some transactions an entity may pay, or expect to pay, consideration to a customer or to a third party that purchases goods or services from that customer. In such cases, the ED proposes that the entity consider whether the consideration it pays, or expects to pay, is:

- (a) a reduction of the transaction price;
- (b) a payment for distinct goods or services that the customer is supplying to the entity; or
- (c) a combination of items (a) and (b).

ED 48

In the case of (c), the entity reduces the transaction price by the amount of consideration payable to the customer in excess of the fair value of the goods or services the entity receives from the customer. However, if the fair value of the goods or services receivable from the customer cannot be reasonably estimated, then the entity defaults to (a) and treats the whole amount of the consideration as a reduction in the transaction price.

ED 49

In cases when the entity considers that the consideration payable to the customer is a reduction in the transaction price, the entity reduces the amount of revenue it recognises at the later of when the entity:

- transfers the promised goods or services to the customer; and
- promises to pay the consideration to the customer.

Observations

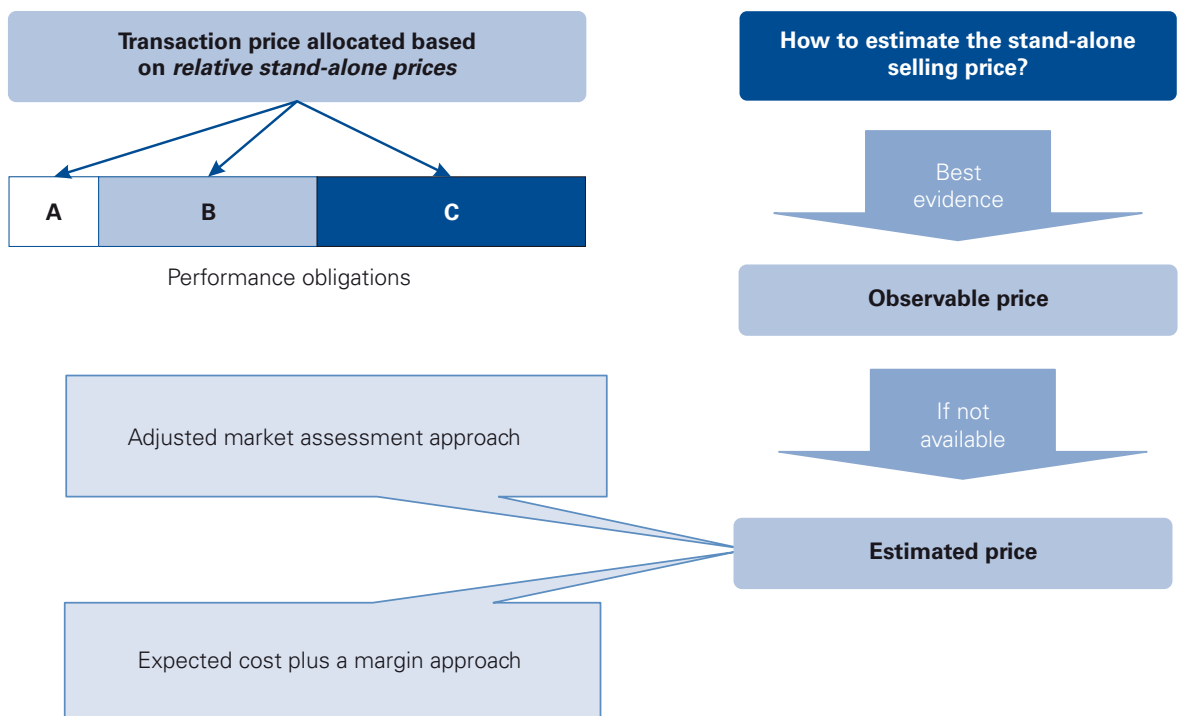
Accounting for customer incentives and similar items is a complex area for which there is limited guidance under current IFRSs. In practice, customer incentives take many forms, including cash incentives, discounts and volume rebates, free/discounted goods or services, customer loyalty programmes, loyalty cards and vouchers. There is some diversity in practice as to whether incentives are accounted for as a reduction in revenue or as an expense, depending on the type of incentive. This issue is discussed in our publication *Insights into IFRS* (4.2.400 - 430) and section 6.3 of this publication.

At first glance, it appears that rebates granted by technology companies in sale contracts with customers typically would result in an adjustment to the transaction price, whereas free or discounted goods or services offered to customers would be accounted for as a separate performance obligation.

5.4 Step 4: Allocate the transaction price to the separate performance obligations

ED 50-53

At contract inception, the entity would allocate the transaction price to separate performance obligations in proportion to their relative stand-alone selling prices. When stand-alone selling prices are not directly observable, an entity would estimate them using approaches such as the “expected cost plus a margin approach” or the “adjusted market assessment approach”.



Illustrative example – Allocating the transaction price to separate performance obligations

Company Y sells medical imaging devices and related services such as telephone support services. Y enters into an agreement with a customer for the sale of a medical imaging device along with one year of telephone support services for 125,000. Y regularly sells one-year telephone support services to other customers on a stand-alone basis for 25,000. Y does not sell imaging devices separately from the telephone support services. However, in its last board meeting management considered selling the device separately from the telephone support service and has tentatively agreed to sell the device for 110,000.

At the time of sale, Y promises to deliver a specific upgrade of the software embedded in the device with specified features and functionality. Y intends to sell this specified software upgrade to all its customers once developed. The sales and marketing department estimates based on survey data that customers will be willing to buy this upgrade for 12,000.

Y assesses that each of the three deliverables in the contract, the medical imaging device, one year of telephone support services, and the specified upgrade, have function distinct from each other and the profit margins can be separately determined. Due to the overall significant discount of approximately 15 percent, the three deliverables are priced interdependently of each other, and therefore the contract cannot be segmented. Therefore, Y concludes that it has three separate performance obligations in the contract with the customer.

Accordingly, Y allocates the total consideration of 125,000 based on its best estimate of the selling price of the device and specified upgrade right as follows:

Performance obligations	Stand-alone selling prices	Selling price ratio	Price allocation
Medical imaging device (estimated selling price)	110,000	75%	93,750
One year of telephone support services (stand-alone selling price based on renewals)	25,000	17%	21,250
Specified upgrade right (adjusted market assessment approach)	12,000	8%	10,000
Total	147,000	100%	125,000

Note: The time value of money and customer credit risk have been ignored for the purpose of this example.

Observations

IAS 18 does not prescribe an approach to the allocation of consideration to components of a transaction that is applied to all transactions. There is specific guidance on allocation in recent interpretations such as IFRIC 13 in respect of customer loyalty programmes and IFRIC 15 in respect of real estate sales. Under these interpretations, consideration could be allocated to components using either of the following methods:

- by reference to the relative fair values of the components; or
- to the undelivered components by reference to their fair value with the balance to components delivered upfront ("residual method").

IFRIC 13. BC14,
IFRIC 15.8

The ED proposes that an entity allocate the transaction price to separate performance obligations by reference to the relative stand-alone selling prices of goods or services. With respect to goods and services that are expected to be released, stand-alone selling prices conceptually can be determined by estimating the price customers in that market are willing to pay. Any subsequent change in the selling prices of these products does not have the effect of reallocating the transaction price among the separate performance obligations based on revised ratios.

Further, at first glance the proposals do not change the current practice of allocating revenue based on the relative fair value method. Generally, a change from the residual method to the approach proposed in the ED would have the effect of accelerating the recognition of revenue.

ED BC125

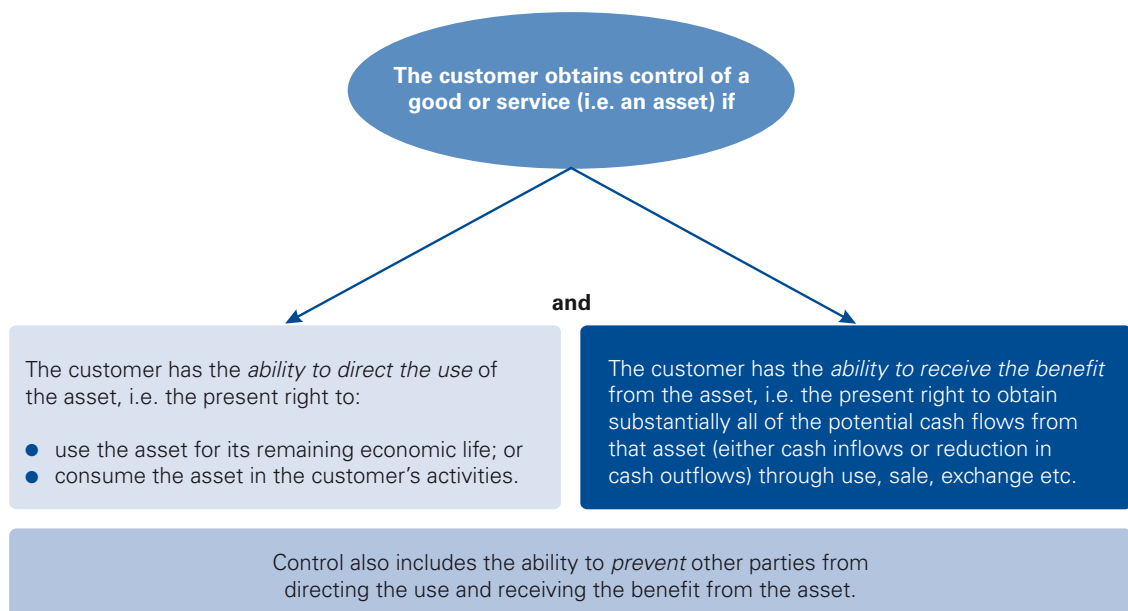
While the residual method should not be used to allocate the transaction price to separate performance obligations, the Boards note that a residual or reverse residual technique may be an appropriate method for estimating a stand-alone selling price if there is a directly observable price for one performance obligation but not the other. In certain circumstances, the application of these techniques could result in accounting outcomes that are comparable to the residual or reverse residual methods.

5.5 Step 5: Recognise revenue when each performance obligation is satisfied

5.5.1 The “transfer of control” approach

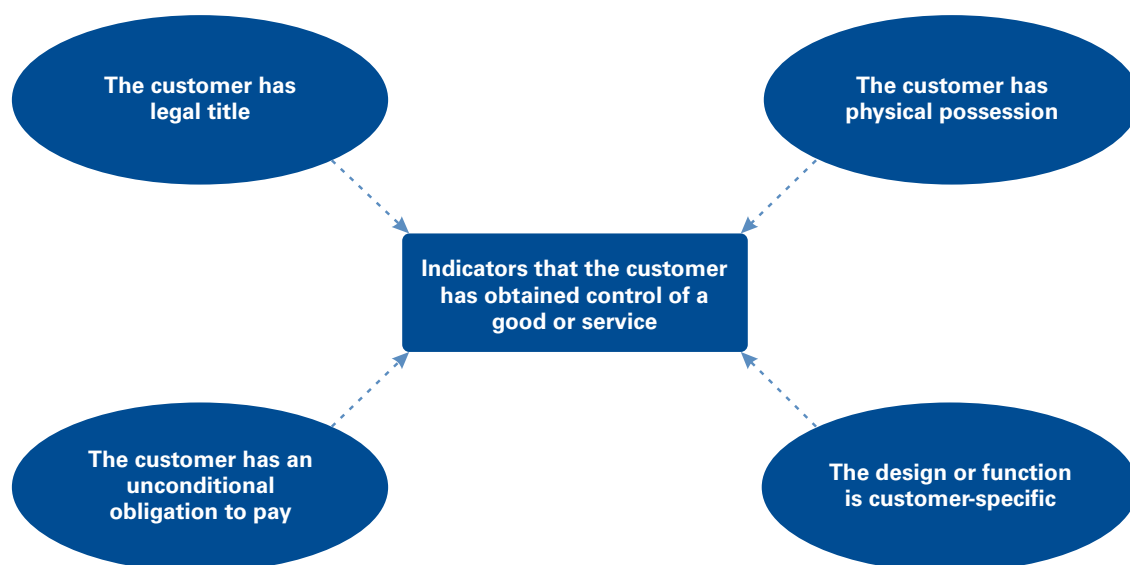
ED 25-28

The ED proposes that an entity recognise revenue when a performance obligation is satisfied. A performance obligation would be satisfied when the customer obtains control of the promised goods or services. This assessment would be made at the performance obligation level.



ED 30

The ED proposes an indicator approach to determining when the customer has obtained control of a good or service:



ED 31

No single indicator in isolation would determine whether the customer has obtained control of the goods or services. For example, physical possession may not coincide with control of the goods in the case of consignment arrangements (see section 6.7) and bill-and-hold arrangements (see section 6.5).

Illustrative example – Revenue recognition upon satisfaction of performance obligations

Continuing with Illustrative example *Allocating the transaction price to separate performance obligations* in section 5.4, Y will recognise revenue for the identified separate performance obligations as follows:

Performance obligations	Amount of revenue	When to recognise revenue	Rationale
Medical imaging device	93,750	Recognised upon delivery.	Upon delivery the customer has the present ability to direct the use of as well as receive benefits from the use of the device. Further, the customer has physical possession as well as legal title to the device.
One year of telephone support services	21,250	Recognised on a straight-line basis over the period of telephone support.	The customer has the ability to receive telephone support as soon as the device is delivered. The telephone support services are provided on a continuous basis over the contract period. Similar to subscription accounting, revenues would be recognised on a straight-line basis.

Performance obligations	Amount of revenue	When to recognise revenue	Rationale
Specified upgrade right	10,000	Recognised when the upgrade right is made available, whether or not the customer chooses to download the upgrade.	The customer presently does not have possession of the upgrade right in order to direct the use of or receive benefits from its use. Therefore, transfer of control has not taken place. Upon delivery, the customer will be able to exercise control (i.e. direct the use of as well as enjoy the benefits from its use). Additionally, it will have both physical possession as well as legal title to the right.

Observations

IAS 11.22,
18.14, 20

The transfer of control approach is a key change in the proposals compared to current standards, as illustrated below:

Proposal	Current standard
Revenue is recognised when the customer <i>obtains control</i> of the promised good or services	<p>Sale of goods in the scope of IAS 18: revenue is recognised when the entity has transferred to the buyer the <i>significant risks and rewards of ownership</i> (amongst other criteria)</p> <p>Sale of goods in the scope of IAS 11 and rendering of services: revenue is recognised by reference to the <i>stage of completion</i> of the transaction at the end of the reporting period</p>

The proposed change in emphasis from a “risks and rewards” approach to a “transfer of control” approach is central to many current standard-setting projects, including consolidation, derecognition and lease accounting, and has proved controversial in each case.

In the case of the revenue project, the implications of the change in approach are pervasive and are discussed throughout this publication. The significance of the effect will vary from industry to industry and transaction to transaction.

One key areas of focus will be the withdrawal of the IAS 11 approach under which technology companies, such as IT consulting, and software and services companies, use the percentage of completion or proportional performance methods to recognise revenue throughout the contract term for long-term contracts, such as the development of software products or IT solutions as specified by customers. A similar revenue recognition outcome may arise under the proposals if control of the software product or IT solution being developed is transferred to the customer continuously, as discussed below. The ED does not envisage that revenue relating to a satisfied performance obligation would be limited to the amount that is not dependent/contingent upon the performance of future obligations under the contract. This may result in a significant change from current practice for some technology companies.

5.5.2 Continuous transfer

ED BC73

In some cases, the transfer of a good or service such as a non-exclusive software or equipment to the customer will take place at a point in time. In other cases, such as in the case of post-contract support services, IT consulting services etc. the transfer of goods or services to the customer will take place continuously over a period of time. To recognise revenue in such cases, the entity determines the amount of the performance obligations satisfied during each reporting period.

ED B63-B66

It may be difficult to determine whether the entity transfers control of the goods or services continuously or at a point in time, particularly when the entity promises to produce, manufacture or construct an asset specifically for a customer. In such cases, the entity would evaluate which party controls the work in progress in order to assess whether control transfers continuously or at a point in time.

- If the customer has the present ability to direct the use of and receive the benefit from the work in progress, then control transfers continuously to the customer.
- If the customer does not control the asset as it is produced, manufactured or constructed, then control transfers at a point in time, i.e. when the customer has obtained control of the completed asset.

ED 32, 33

If the entity assesses that the customer obtains control of the goods or services continuously, then it applies the revenue recognition method that best depicts the transfer of control of the goods or services, i.e. when performance occurs. This method is applied consistently to similar performance obligations.

ED 33

Suitable methods to depict the continuous transfer of goods or services, depending on the specific facts and circumstances of a contract, include:

- output methods, i.e. methods based on units produced or delivered, milestones, surveys etc;
- input methods, i.e. methods based on efforts expended to date; and
- methods based on the passage of time that would for instance be suitable for services transferred evenly over a period.

The following is an example in which the customer obtains control of the product on a continuous basis and revenue is recognised on the basis that depicts the transfer of control.

Illustrative example – Continuous transfer

Company S develops customised software for customers. It enters into a contract with Customer C to develop and install customer relationship management (CRM) software that will provide information to C's management in order to better manage its sales and inventory, and make available raw materials at the right place just in time for production. The total contract value is 100,000. Non-refundable progress payments are made on a monthly basis for work completed per the contract terms.

The design of the CRM software is customised to C's needs. Further, C is highly involved in the design and specifies any additional functions or features (usually for an additional fee) throughout the development process. If the contract is terminated, then C obtains control of the part-completed CRM software along with the source code that will be necessary for another software vendor to complete the project. Other software vendors could provide the development services in that event. C is not entitled to any refund of payments for work performed to date.

The terms of the contract and all the related facts and circumstances, as discussed below, indicate that C “controls” the software as it is developed:

- C has an unconditional obligation to pay throughout the development process as evidenced by the required progress payments (with no refund of payment for any work performed to date), and the requirement to pay for any partially completed project in the event of contract termination.
- C is actively involved in the design and development phase and requests any additional features or functionality throughout the development phase.
- C has the ability to take possession of the work in progress (i.e. source code) and engage another software vendor to complete the project.
- S cannot direct the use of and receive the benefits from the software. Although C obtains legal title of the software only on delivery of the completed project, the right to retention of the title by S is a protective right, and not an indicator that S has retained control.

Revenue is recognised on a continuous basis and S would use either the output method such as the contract milestone achieved to date proportionate to the total contract value, or the input method that recognises revenues on the basis of efforts expended such as labour hours.

Observations

The notion that control of a good or service may be transferred to a customer continuously is similar to the notion in IFRIC 15 that the conditions to recognise a sale of goods may be met continuously over time in the case of a sale of real estate under construction. However, IFRIC 15 retained IAS 18’s risks and rewards approach whereas the ED focuses on the transfer of control. In addition, the ED extends this notion to all transactions, including those currently in the scope of IAS 11.

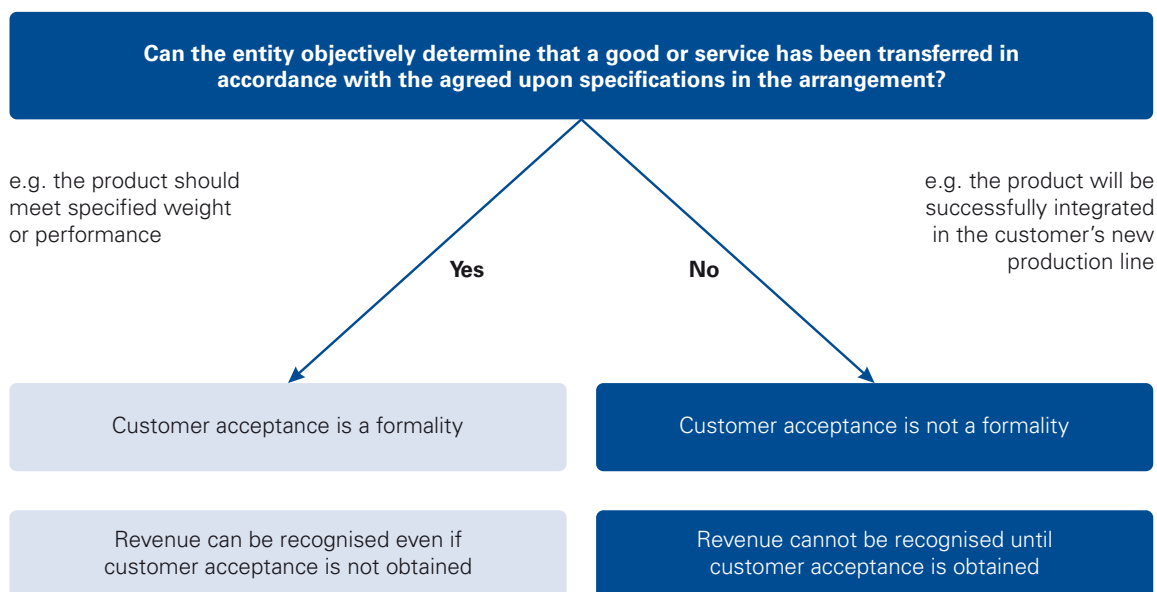
Technology companies would be required to analyse terms and conditions with respect to their long-term contracts, and determine whether terms in those contract provide for transfer of control on a continuous basis to the customer in order for it to recognise revenue as the contract progresses. If the transfer of control is not on a continuous basis, but rather occurs at a point in time, then revenue per the proposals would be recognised when control is transferred. The assessment of whether control transfers on a continuous basis or at a point in time will be one of the most critical judgements to be made by technology companies in applying the proposals in the ED.

5.5.3 Customer acceptance

ED B69-B73

Some contracts include customer acceptance clauses that are substantive contractual terms that ensure the customer’s satisfaction with the goods or services promised in the contract. An entity considers the effect of acceptance clauses in determining whether a customer has obtained control of a promised good or service.

Acceptance clauses may affect the date control passes to the customer, as follows:



Illustrative example – Customer acceptance

Company R licenses ATM payment processing software to banks. R enters into an arrangement with Bank B, a new customer, to licence its standard ATM payment processing software. B specifies that the software must be able to process at least 10,000,000 transactions per week. Customer acceptance is indicated by either a formal sign-off by the customer or the passage of 90 days without a claim under the acceptance provisions.

This is an example of an acceptance provision based on objectively determinable customer-specified criteria. Formal customer sign-off provides the best evidence that the customer-specified acceptance provision has been met. However, revenue recognition also would be appropriate if R is able to objectively demonstrate that the software is able to process the requisite number of transactions in the customer's processing environment. This determination would depend on the specific facts and circumstances, including B's size relative to R's other customers, the similarity of B's IT environment and ATM hardware to R's other customers, and R's historical experience with other customers.

For example, it would be unlikely that R would be able to objectively demonstrate that the software has the capability to process 10,000,000 transactions per week if it typically processes only 100,000 transactions per week for other customers. However, R would have an ability to objectively demonstrate that it can meet this criterion if the software typically processes 50,000,000 transactions per week for other customers.

Observations

These proposals are more detailed than the current requirements in IAS 18 relating to customer acceptance.

The ED does not discuss the potential interaction between acceptance clauses and the assessment of whether control of the goods or services transfers to the customer on a continuous basis or at a point in time. This could be a major issue for technology companies providing software development or IT consulting services, and manufacturers of customised equipment or products in contracts in which the customer certifies its acceptance of work done on a phased basis by reference to specific project milestones, or on completion of the project.

IAS 18.IE2

5.6 Contract costs

ED 57

The ED proposes that if the costs of fulfilling a contract are not eligible for capitalisation under other IFRSs, then a separate asset would be recognised only if the costs relate directly to future performance under a contract and are expected to be recovered. Otherwise they would be expensed.

ED 58, 59

The ED includes a list of direct costs that would be eligible for capitalisation if other criteria are met, as well as a list of costs that would not be eligible for capitalisation and therefore would be recognised as expenses when incurred.

Direct labour <ul style="list-style-type: none"> e.g. employee wages 	✓	Costs of obtaining a contract <ul style="list-style-type: none"> e.g. marketing, bid and proposal, commissions 	✗
Direct materials <ul style="list-style-type: none"> e.g. inventory to customer 	✓	Costs that relate to a satisfied performance obligation	✗
Allocation of costs that relate directly to the contract or contract activities <ul style="list-style-type: none"> e.g. cost of contract management or depreciation of tools and equipment used in fulfilling the contract 	✓	Abnormal amounts of wasted materials, labour, or other contract costs	✗
Costs that are explicitly chargeable to the customer under the contract	✓	<ul style="list-style-type: none"> Direct costs that would be eligible for capitalisation if other criteria are met 	
Other costs that were incurred only because the entity entered into the contract <ul style="list-style-type: none"> e.g. subcontractor costs 	✓	<ul style="list-style-type: none"> Costs to be expensed when incurred 	

ED 61

If the costs of fulfilling a contract are recognised as an asset in accordance with the ED, then the asset recognised would be amortised as the entity transfers the related goods or services to the customer. Impairment considerations are discussed in 5.7.3.

ED B90

Illustrative example – Contract costs

Technology Company T enters into a contract to outsource a customer's IT data centre for five years. T incurs costs of 10,000 to obtain the contract (that is, for selling commissions). Before providing the services, T designs and builds a technology platform that interfaces with the customer's systems. That platform is not transferred to the customer.

The customer promises to pay a fixed fee of 20,000 per month.

Initial set-up costs incurred are as follows:

Design services	40,000
Hardware and software	210,000
Migration and testing of data centre	100,000
Total	350,000

The 10,000 costs of obtaining the contract are recognised as expenses when incurred. The initial set-up costs relate primarily to activities to fulfil the contract but do not transfer goods and services to the customer. T would account for the initial set-up costs as follows:

- *Hardware costs.* Accounted for in accordance with IAS 16 *Property, Plant and Equipment*.
- *Software costs.* Accounted for in accordance with IAS 38 *Intangible Assets*.
- *Costs of the design, migration, and testing of the data centre.* These costs would be eligible for capitalisation under the ED. The resulting asset would be amortised in accordance with the pattern of transfer of outsourcing services to the customer.

ED BC149

Observations

The inclusion of specific guidance on the capitalisation of certain contract costs in the ED represents a change in approach taken by the Boards in the DP. The objective of the guidance is to clarify the circumstances in which entities may recognise contract costs as an asset. However, the focus of the ED remains on revenue and costs; for example, there is no separate concept of a contract margin to be recognised over the term of a long-term contract.

The lists of costs that may and may not be eligible for capitalisation under the ED are broadly similar to the lists of costs that may or may not meet the definition of contract costs under IAS 11. However, the ED also requires that costs eligible for capitalisation generate or enhance resources of the entity that will be used in satisfying performance obligations in the future. As a result, and as stated explicitly in the ED, the costs of obtaining a contract would be recognised as expenses when incurred, while under the current requirements costs for securing a specific contract may be eligible for capitalisation if they are clearly identified, can be reliably measured and it is probable that the contract will be obtained.

Technology companies, such as cloud service providers incur significant costs, such as commissions to internal sales personnel and external sales agents, for the purpose of acquiring new customers (also referred to as “subscriber acquisition costs”). At first glance, the proposal in the ED is expected to have a significant impact on technology companies that currently capitalise subscriber acquisition costs, as it appears that these would no longer be eligible for capitalisation. However, it is unclear whether a new standard on revenue recognition based on the proposals would be the only relevant standard under which the accounting for such costs would be evaluated.

In addition, the ED appears to use more restrictive language than IAS 11 relating to allocated costs. IAS 11 permits indirect costs attributable to contract activity to be allocated to specific contracts; the ED refers only to the allocation of costs that relate directly to the contract or contract activities. It is not clear whether the ED intends to restrict the extent of allocated costs eligible for capitalisation.

5.7 Changes in terms and estimates

5.7.1 Contract modifications

ED 17-19

A contract modification is any change in the scope or price of a contract initiated by the entity or by the customer.

Under the ED an entity would account for a contract modification as a separate contract if the original contract and the contract modification are priced independently (see 5.1.2). Otherwise, the entity would account for the contract modification together with the original contract, and would recognise the cumulative effect of the contract modification in the period in which the modification occurs as if the modification had been included in the existing contract.

The following example illustrates a situation in which a contract modification is accounted for together with the original contract:

ED B3

Illustrative example – Contract modification

Software Company S provides maintenance services to customers with respect to digital imaging devices. It enters into a three-year maintenance services contract. The payment terms are 100,000 payable annually in advance. The stand-alone selling price of the maintenance services at contract inception is 100,000 per year.

At the beginning of the third year, after the customer had paid the 100,000 for that year, S agrees to reduce the price for the third year of services to 80,000. In addition, the customer agrees to pay an additional 180,000 for an extension of the contract for three years.

The services provided during the first two years are priced at their stand-alone selling prices of 100,000 per year. However, the services provided during the subsequent four years are priced at a 40,000 discount ((80,000 stand-alone selling price per year x 4 years) - (100,000 prepayment + 180,000 remaining payment)), and S concludes that the price is dependent on the price of the services in the original contract. Therefore, S concludes that the price of the modification and the price of the original contract are interdependent.

Consequently, S accounts for the modification together with the original contract. At the date of modification, S recognises the cumulative effect of the contract modification as a reduction of revenue in the amount of 40,000 ((480,000 total consideration ÷ 6 years of total service x 2 years' service provided) - 200,000 revenue recognised to date). S recognises revenue of 100,000 per year for the first two years, 40,000 in the third year, and 80,000 per year during the subsequent three years.

IAS 11.13, 14

Observations

Modifications to long-term contracts are common in the technology sector. For long-term construction type contracts, IAS 11 includes specific guidance on accounting for variations (modifications arising from instructions from the customer) and claims by the entity for costs not included in the original contract price. That guidance focuses on assessments of the probability that the variation or claim will be agreed, and of whether the revenue can be measured reliably.

In essence, the approach in the ED is to apply the general guidance on revenue recognition to contract modifications, either reflecting them as part of the originally identified contract or as a new contract. This may result in a change in current practice for technology companies.

5.7.2

Changes in the transaction price

ED 53

After contract inception, there may be changes in the transaction price. Such changes may arise, for example, from a change in the estimate of variable consideration, or because it becomes possible to reasonably estimate an element of variable consideration that previously was excluded from the transaction price.

ED 53

Any such change in the transaction price would be allocated to all performance obligations, including performance obligations that have been satisfied. If part of a change in the transaction price is allocated to a performance obligation that has been satisfied, then an adjustment to revenue would be recognised in the period in which the change occurs.

Illustrative example – Change in transaction price arising from variable consideration

Company B enters into a contract for the sale of photocopier equipment and three-year telephone support services to a customer. The contract states that the total contract price is 115, plus an extra 20 if the equipment runs for the first two-year period with no unscheduled stoppages. B has determined that the stand-alone selling price for the photocopier equipment is 50 and 75 for the telephone support services. B cannot estimate reasonably whether the extra 20 will be earned before the end of the second year, and therefore the transaction price is estimated as 115 until that date.

B determines that the sale of the equipment and the telephone support services are two separate performance obligations in a single contract (see 5.1.2 and 5.2.1).

At the end of year 2, B determines that the extra fee of 20 will be earned. Therefore, the transaction price for the contract is now 135 (115 + 20).

B allocates the transaction price as follows:

Performance obligation	Stand-alone selling price	Allocation percentage	Initial allocation of transaction price	Revised transaction price	Allocation percentage (not revised)	Revised allocation of transaction price
Equipment	50	40%	46	N/A	40%	54
Telephone support services	75	60%	69	N/A	60%	81
Total	125	100%	115	135 (115+20)	100%	135

The cumulative revenue to be recognised by B at the end of year 2 for the contract is 108: 54 for the sale of the equipment and 54 (2/3 of 81) for telephone support services. As B has recognised revenue amounting to 69 (46 + 69/3) in year 1, it will recognise revenue amounting to 39 (108 - 69) in year 2 related to the contract.

Even though the revenue on the sale of equipment was recognised in year 1, the transaction price allocated to that performance obligation is affected as the change in transaction price is allocated to all performance obligations, and the relative weighting of each performance obligation in the contract cannot be changed after inception of the contract.

However, if it had been determined that the sale of the equipment and the telephone support services were two different contracts (see 5.1.2), then the outcome would be different. In that case, at the end of year 2 when the B determines that the extra amount of 20 will be earned, this would affect only the transaction price of the telephone services contract.

Contracts	Stand-alone selling price	Allocation percentage	Initial allocation of transaction price	Revised transaction price
Equipment	50	40%	46	46
Telephone support services	75	60%	69	89 (69+20)
Total	125	100%	115	135

The cumulative revenue to be recognised by B for the telephone services contract would be 59 (2/3 of 89). As B has recognised revenue amounting to 23 in year 1 for the telephone support services, it would recognise revenue amounting to 36 (59 - 23) in year 2 related to such services. The revenue on the sale of equipment that was recognised in year 1 (46) would not be affected as it arises under a separate contract.

Note: The time value of money and customer credit risk have been ignored for the purpose of this example.

Observations

Under these proposals, changes in the transaction price are allocated to all performance obligations within a contract. That is, the contract is the unit of account in the first instance.

The ED proposes a form of prospective adjustment, consistent with the general approach to revisions of estimates under IAS 8. Other forms of prospective adjustment considered and rejected by the Boards were to recognise the whole of the change in the transaction price in comprehensive income in the period in which it occurs, and to allocate the change only to unperformed performance obligations.

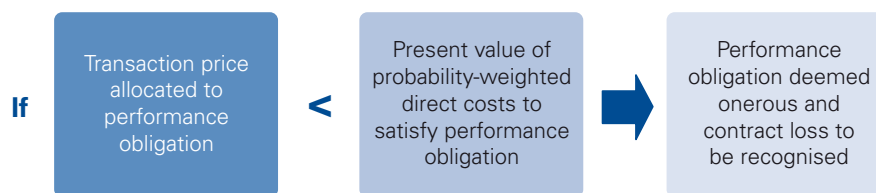
Technology companies would apply the above approach only when there is a change in the transaction price. There would be no change in the allocation of the transaction price if there is a change in the stand-alone selling prices of goods or services, notwithstanding that the transaction price is allocated initially on the basis of relative stand-alone selling prices.

5.7.3 Onerous performance obligations

ED 54-56

The ED proposes that an entity evaluate whether an onerous performance obligation exists by considering whether the present value of the probability-weighted direct costs of satisfying a separate performance obligation exceed its allocated transaction price.

An onerous performance obligation would exist in the following circumstances:



ED 55

The direct costs mentioned in the above onerous test correspond to those described in section 5.6.

ED 55

Any loss arising from an onerous performance obligation would be first recognised as an impairment loss against any recognised asset relating to the contract (e.g. inventory). If the amount of the contract loss exceeds the carrying amount of the related assets, then the excess would be recognised as a separate liability for the onerous performance obligation.

ED 56

Any subsequent change in the measurement of such a liability would be recognised as an expense or as a reduction of an expense, not as an adjustment to revenue.

Illustrative example – Onerous performance obligation

In 2010 Company B enters into a contract to supply 1,000 high-definition televisions to X in 2011. The televisions are to be built to a standard design and B determines that the televisions are transferred at a point in time upon their delivery to X.

B enters into this contract to maintain production capacity in Country Z. In 2010 B estimates that the transaction price under the contract will cover only the direct variable costs of fulfilling the contract as follows (time value of money ignored):

Transaction price	10,000
Direct variable costs	(10,000)
Allocation of costs that directly relate to contract activities	(3,000)
Present value of probability-weighted direct costs	<u>(13,000)</u>

B recognises 3,000 as a contract loss and a corresponding liability for onerous performance assuming there is no inventory or other assets against which the loss would be first recorded.

Observations

Under current IFRSs, an entity is required to recognise a contract loss in advance of performance if it assesses that a contract is onerous (IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*) or if it is probable that a construction contract will make a loss (IAS 11). However, the proposed requirements differ from current practice.

Firstly, the unit of account for recognising a loss under the ED is the separate performance obligation, not the contract. Both IAS 11 and IAS 37 focus on assessing whether a *contract* will be loss-making. Under the ED's proposals, it appears that technology companies would be required to recognise a loss on a performance obligation at inception of the contract. However, the ED does not discuss the potential interaction between the transaction price model and onerous performance obligations, and it is not entirely clear that the Boards' intention is that an onerous performance obligation could arise at inception.

Secondly, there may be differences in recognition and measurement as the ED explicitly requires the entity to consider the probability-weighted amount of the direct costs required to satisfy the performance obligation. This may differ from the amounts that entities currently consider when assessing the "unavoidable costs of meeting an obligation" under IAS 37 and the "total contract costs" under IAS 11.

6. Specific application issues

6.1 Sale of product with a right of return

ED B5, B6

The ED includes guidance on sales transactions in which the entity grants to the customer a right to return the goods sold. The ED distinguishes sales with a right of return from cases in which the customer returns goods that are defective; the latter is subject to guidance on product warranties (see section 6.2).

*ED 37, B9,
B11, B12*

The ED proposes that an entity not recognise revenue for goods that are transferred to a customer but are expected to be returned. Instead, if an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, then the entity would recognise a refund liability measured at the probability-weighted amount of expected refunds. In addition, the entity would recognise an asset for its right to recover the goods from customers on settling the liability, measured initially at the carrying amount of the inventory transferred less the costs expected to recover those goods. Subsequently, the entity would remeasure the refund liability and asset at the end of each reporting period.

The following example illustrates the journal entries arising on transfer of goods to a customer when the customer has a right of return.

Illustrative example – Right of return

ED B12

Company ABC releases a new model of digital equipment, Product Gamma. ABC has released similar digital equipment, Product Alpha and Beta in the last five years. ABC expects that the customer base for Product Gamma likely will be substantially the same as the customer base for the previous products, and ABC will market Product Gamma through the same retail distributors that currently market similar digital equipments.

The returns for existing similar digital equipment have averaged approximately 4 percent of gross sales (i.e. probability-weighted). ABC subjected Product Gamma to extensive testing procedures prior to its release and believes that all significant errors for Product Gamma have been identified and resolved.

ABC enters into a contract for the sale of 1,000 units of digital equipment Gamma for a total contract value of 100,000. The cost of manufacturing Product Gamma is 60 per unit.

ABC concludes that the return experience for Products Alpha and Beta appear to be indicative of the estimated returns for Product Gamma because:

- it has experience with the release of similar products (Products Alpha and Beta);
- the customer base and distribution channel for Product Gamma are substantially the same as that for Products Alpha and Beta; and
- it has performed extensive testing for Product Gamma.

Therefore, ABC records the following journal entries for the right of return (based on 4 percent of gross sales), assuming that all the other revenue recognition criteria are met:

	<i>Debit</i>	<i>Credit</i>
Cash	100,000	
Refund liability (100 x 40 units expected to be returned)		4,000
Revenue		96,000
<i>To recognise sale excluding revenue relating to equipment expected to be returned</i>		
Asset (60 x 40 units expected to be returned) ¹	2,400	
Cost of sales	57,600	
Inventory		60,000
<i>To recognise cost of sales and right to recover equipment from customers</i>		
1 Assuming that the cost to recover the equipment is insignificant		

ED B10 If an entity cannot reasonably estimate the probability of a refund, then the entity would not recognise revenue and would instead recognise any consideration received as a refund liability.

Illustrative example – Right of return

Company ABC released a new curriculum software product, Product B. Product B will be marketed primarily to public and private school districts through ABC's newly hired direct sales force. Historically, ABC has developed only an entertainment software product, Product A, which is marketed through third-party distributors (primarily retail stores and outlets) to customers for home use. The returns for Product A have averaged approximately 2 percent of gross sales of Product A (probability-weighted). ABC subjected Product B to extensive beta testing procedures prior to its release and believes that all significant bugs for Product B have been identified and resolved, although the outlook for the new market for Product B is uncertain.

Because ABC does not have past experience with curriculum software products, and the customer base and distribution channel for Product B are substantially different from that for Product A, generally ABC would not have a sufficient basis to estimate reasonably the amount of returns for Product B. Therefore, ABC would not recognise revenue related to the sale of Product B until the time period for returning the software product has expired. Any consideration received would be recognised as a refund liability.

Once ABC has developed sufficient historical experience with respect to returns for Product B in order to conclude that the amount of returns can be estimated reasonably, revenues would be recognised net of estimated returns with a corresponding liability for refunds, including the right i.e. an asset, to receive the products returned from the customer.

Observations

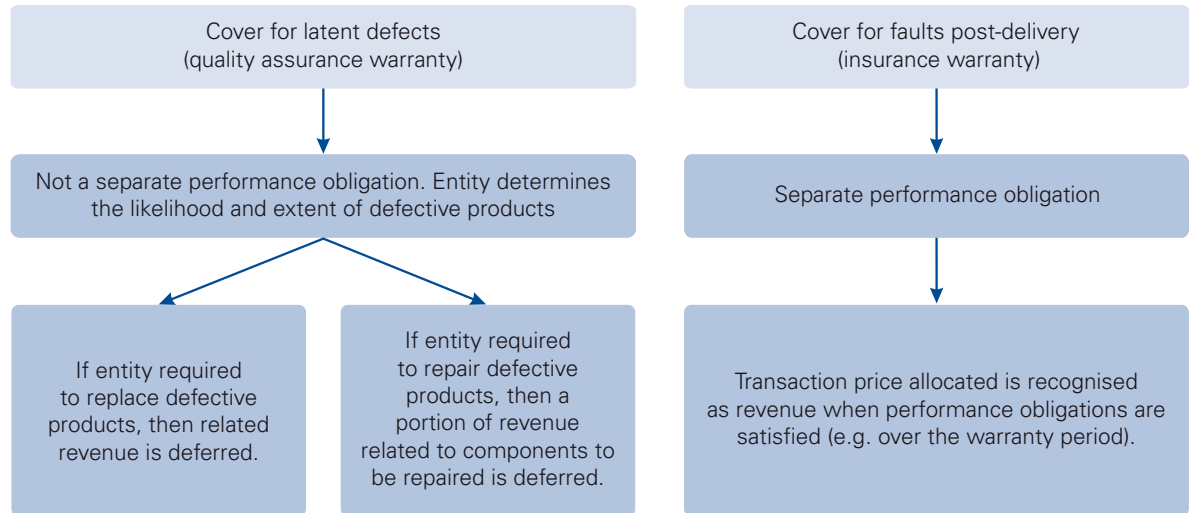
IAS 18.16, App 2(b)

Under IAS 18, if there is uncertainty about the possibility of return, then revenue recognition is deferred until the return period has elapsed. As explained in our publication *Insights into IFRS* (4.2.150), in our view an entity considers historical experience in assessing the possibility of return. If, based on past experience, the entity can make a reliable estimate of the goods that will be returned, then it would be appropriate to recognise revenue for the amount that is expected to be received for items that are not returned (assuming that the other conditions for revenue recognition are met). The ED's proposals for adjusting revenue for expected returns based on previous experience and deferring revenue are broadly similar.

6.2 Product warranties and product liabilities

ED B13-B18

The ED distinguishes between two types of product warranties: cover for latent defects (i.e. defects that exist when the product is transferred to the customer but that are not apparent) and cover for faults that arise after the product is transferred to the customer. The following chart illustrates the consequences on revenue recognition for both types of product warranties:



ED B19

Legal requirements to pay compensation if products cause harm or damage as well as promises to indemnify a customer for liabilities or damages (e.g. arising from claims of copyright) would not be separate performance obligations; instead they would be accounted for in accordance with IAS 37.

Illustrative example – Product warranty

Technology Company SatNav manufactures and sells portable satellite navigation devices along with embedded software that allow customers to access street maps of various cities around the world. Customers can buy off-the-shelf street maps for individual countries, as well as yearly updates of new streets added to existing maps, and download them onto the portable device.

Included within each contract for the sale of a device is a standard warranty that the device including the embedded software will function as per specification. Customers have 30 days from the date of purchase to request SatNav to replace the device or fix the bug relating to the embedded software should it not function per specification. Based on past experience with similar products, SatNav expects that 1 percent of the total monthly sales will require repair/replacement of defective devices. SatNav refurbishes any defective devices recovered from customers and sells them at a profit.

Sales for the month of July 2010 are 1,000 units at 150 per unit. The devices along with embedded software cost SatNav 60 per unit.

The warranty provided by SatNav to repair/replace the device for any defects that existed when the product was transferred to the customer but not apparent is in the nature of “quality assurance”, and therefore is not accounted for as a separate performance obligation. SatNav records the following entries on transfer of the devices:

	<i>Debit</i>	<i>Credit</i>
Cash	150,000	
Refund liability (150 x 10 units expected to be returned)		1,500
Revenue		148,500
<i>To recognise sale excluding revenue relating to units expected to be repaired/replaced</i>		
Asset (60 x 10 units expected to be returned) ¹	600	
Cost of sales	59,400	
Inventory		60,000
<i>To recognise cost of sales and the right to recover units from customers</i>		
1 Assuming that the cost to recover the units is insignificant		

Observations

IAS 18.16(a), 17
37.App C4

Under IAS 18 a standard warranty clause in a sale contract that does not result in the retention of significant risks by the seller would not preclude the recognition of revenue at the date of sale. In this case, a warranty provision is recognised in accordance with IAS 37 at the date of sale of the product for the best estimate of the costs to be incurred for repairing or replacing defective products. However, an abnormal warranty obligation may indicate that the significant risks and rewards of ownership have not been passed to the buyer such that revenue recognition should be deferred.

The proposals are expected to change current accounting practice; instead of accruing for warranty costs, technology companies would recognise an asset (i.e. right to receive the expected returned product) and a refund liability for the products expected to be returned due to latent defects.

Unlike current IFRSs, the ED does not envisage that the presence of a warranty would preclude recognition of all revenue associated with the sale. This reflects the change from a risks and rewards approach to a transfer of control approach in the model. Instead, the ED proposes that cover for faults post-delivery would result in deferral of a portion of revenue in all cases, and that cover for latent defects would result in deferral of a portion of revenue when some of the products transferred are expected to be defective. In practice, technology companies will be required to exercise judgement in order to assess the nature of a particular form of warranty and determine whether it is a separate performance obligation.

Further, with respect to faults covered post-delivery, or extended warranties as commonly referred to in the technology sector, the proposals in the ED may result in a change in current accounting practice for some technology companies. In our experience, currently there exists diversity among technology companies with respect to accounting for extended warranties, as some account for these as a separate component of the contract, whereas others accrue costs with respect to extended warranties in their financial statements. The ED does not discuss explicitly how this proposal interacts with the general principles for the identification of separate performance obligations depending on whether goods or services are distinct (see section 5.2). It is not clear therefore whether the Boards intend there to be an *a priori* assumption that such cover always is a separate performance obligation, or expect entities to evaluate whether such cover is a separate performance obligation on a case-by-case basis.

The ED notes that some forms of product warranty may meet the definition of an insurance contract under IFRS 4. It will be important that, taken together, the new standards on revenue recognition and insurance contracts are clear as to the treatment of product warranties and as to which standard to apply.

6.3

Customer incentives

6.3.1

The variety of customer incentives

ED B24

An entity may provide incentives to a customer as part of a sales contract. Customer incentives offered by a seller can have various forms; they include cash incentives, discounts, volume rebates, free or discounted goods or services, customer loyalty programmes, loyalty cards and vouchers. Accounting for customer incentives is often a challenging issue. The diagram below identifies examples of accounting issues related to customer incentives and how they are dealt with in the ED.

Examples of customer incentives	Upfront payments to customers	Volume rebates/ early settlement discounts	Free or discounted goods or services included in a sales transaction	Customer options for additional free or discounted goods or services
Accounting issues	Reduction of transaction price or payment for distinct goods or services?	Effect on estimate of transaction price?	Separate performance obligations? How to allocate transaction price?	Does the option provide a material right to the customer?
Reference in this publication	5.3.5	5.3.1	5.4	6.3.2

6.3.2

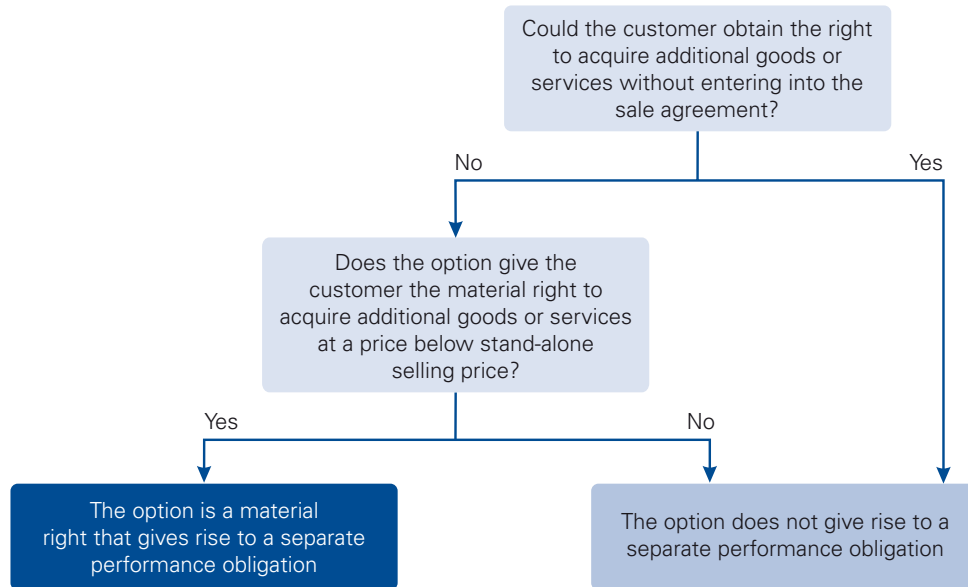
Customer options for additional goods or service

ED B24-B26

When the entity grants a customer an option to acquire additional goods or services, that option gives rise to a separate performance obligation in the contract only if the option provides a material right that the customer would not receive without entering into that contract.

ED B25, B26

The conditions for an option for additional goods and services to be considered a material right and give rise to a separate performance obligation are as follows:



ED B87

The estimate of the stand-alone selling price for a customer’s option to acquire additional goods and services would reflect the discount the customer would obtain when exercising the option, adjusted for the following:

- any discount that the customer would receive without exercising the option; and
- the likelihood that the option will be exercised.

Illustrative example – Customer option for additional goods or services

Software Company S sells payroll software along with related services such as telephone support on a yearly basis. Customers can renew the yearly telephone support services by paying renewal fees. S has the history of increasing telephone support service fees by 5 percent each year.

S enters into a contract with Customer C to provide one year of telephone support services for 100,000. At the end of the year, C has the option to renew the contract for a second year by paying an incremental amount of 2 percent, i.e. fees for the second year would be 102,000 (100,000 x 1.02) as compared to 105,000 (100,000 x 1.05) based on the standard increment of 5 percent. Further, C also is granted the option to renew for a third year for an incremental fee of 2 percent over the previous year’s fees, i.e. 104,040 (102,000 x 1.02) as compared to 110,250 (i.e. 105,000 x 1.05) based on the standard increment of 5 percent for that year.

The renewal option is for a continuation of support services and those services are provided in accordance with the original terms of the contract. S concludes that the renewal option provides a material right to the customer. Therefore, S would allocate the transaction price by considering the amount in exchange for all the services that are expected to be provided.

Suppose 90 percent of all customers (including Customer C) are expected to renew at the end of the first year and 90 percent of those customers are expected to renew at the end of the second year.

S estimates the stand-alone selling price of the option as follows:

Year	Stand-alone selling prices without the option	Expected consideration	Value of the option
1	100,000 (100,000 × 100%)	100,000 (100,000 × 100%)	Nil
2	94,500 (100,000 × 1.05 × 90%)	91,800 (100,000 × 1.02 × 90%)	2,700
3	89,303 (100,000 × 1.05 ² × 90% × 90%)	84,272 (100,000 × 1.02 ² × 90% × 90%)	5,031
Total	283,803	276,072	7,731

Note: The time value of money and customer credit risk have been ignored for the purpose of this example.

Observations

The ED proposes the withdrawal of IFRIC 13, which contains specific guidance on accounting for customer loyalty programmes. The proposed approach under the ED would introduce a number of changes in this area; for example:

- the residual method for allocating consideration between components of a transaction that is permitted in IFRIC 13 is not permitted under the ED (see also 5.4.1); and
- the time value of money is taken into account in the measurement of the allocated transaction price of the award credit in the ED whereas it is ignored in IFRIC 13.

Moreover, the presentation of the liability for award credits prior to redemption would change under the proposals: the liability would become part of the net contract asset/liability whereas currently it is presented as deferred revenue.

Technology companies often grant customers the option to purchase additional goods and services at increasing discounts. The proposals in the ED to account for these options as separate performance obligations if they are considered material rights is likely to be of significant impact to technology companies and may result in change in current accounting practice for some.

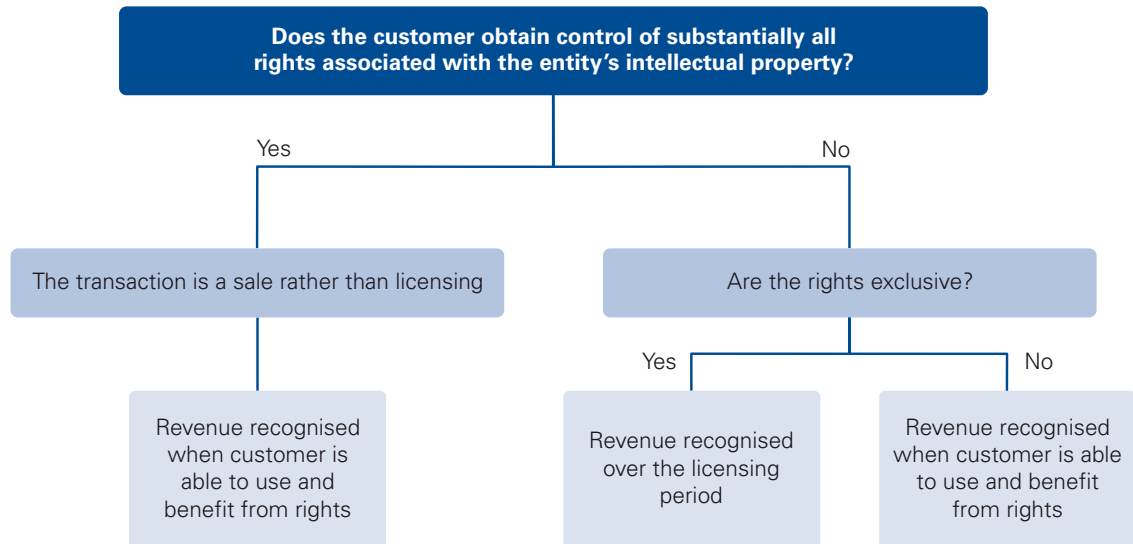
The ED is not clear regarding the accounting treatment of customer options to buy free or discounted products granted on a discretionary basis rather than as part of a sales transaction (e.g. discount vouchers). It is not clear whether such options are intended to be in the scope of the ED, as there is no performance obligation at the date the vouchers are distributed and one could argue that there is no contract before the customer actually redeems the vouchers. However, if a customer presented such a discount voucher at the time of entering into a contract, then this would in effect reduce the transaction price.

IFRIC 13.
BC14(b)
IFRIC 13.
BC22(d)

6.4 Licensing and right of use

ED B31-B35

The ED proposes specific guidance on arrangements in which an entity grants a customer the right to use, but not own, intellectual property. The proposed guidance focuses on whether control of all the rights associated with the entity's intellectual property are or are not transferred to the customer, as follows:



ED B36, B37

If an entity can grant similar rights to other customers under substantially the same terms, then the rights would not be exclusive. Rights could be exclusive during a certain period of time, or in a specified geographical area or distribution channel.

Illustrative example – Licensing and rights of use

Scenario 1 – Non-exclusive licence

Company ABC develops interactive training courses for accountants that enable users to earn continuing professional education (CPE) credits upon completion of a course and passing a final test on the course material. These courses generally are downloaded from the internet onto the user's computer, although users can elect to receive the training courses on CD. The courses possess interactive functionality, whereby the user's responses to individual questions throughout the course provide the basis for determining the subsequent content of the learning material provided to the user. In this way the user's learning experience is enhanced and the user is better prepared for the final test. ABC enters into contracts with accounting firms and individual professionals and grants them the non-exclusive right to use the same software in concurrent periods. ABC owns the patent to the intellectual property and provides customers a written contract guarantee that it has a valid patent and will defend and maintain the right should it be subject to dispute or violation.

On purchase of the non-exclusive right to use the training software, customers do not obtain the right to control the intellectual property. They merely obtain the right to use and benefit from the training software. Accordingly, revenue is recognized on the sale of the non-exclusive right as soon as the customer is able to use the software.

Further, the obligation to maintain and defend the patent rights is not a performance obligation as it does not transfer any goods or service to the customer.

Note: Customer credit risk and product warranty obligation have been ignored for the purpose of example.

Scenario 2 – Exclusive licence

Technology Company T owns the patent to the intellectual property for certain micro-processors that can be used in computers and smart-phones. It enters into an exclusive architecture licensing agreement that enables X to build a customised processor for its specific applications and products. Under the terms of the contract with X:

- T will receive an upfront fee of 1,000,000 plus additional fees of 0.50 per unit sold by X in which the processor is embedded;
- T continues to own the patent and intellectual property of the processor;
- X has the exclusive licence to use the intellectual property for a period of three years. The contract is renewable thereafter based on mutual consent; and
- T will not grant any other company the right to use the intellectual property during the term of the contract for applications and products similar to those built by X.

T determines that X has not obtained “control” of substantially all of the rights associated with the intellectual property. This is because X has the ability to use the licence only for three years and for specific applications and products.

Accordingly, T recognises revenue based on the method that represents the pattern of satisfaction of the performance obligation: 1,000,000 is recognised over the three-year licensing period and the royalty payments are recognised as and when the products are sold.

Observations

IAS 18.IE20,
ED IN25(c)

IAS 18 states that fees and royalties paid for the use of an entity’s assets are recognised according to the substance of the arrangement, noting that in some cases the fees will be recognised over time (perhaps on a straight-line basis) and in some cases the arrangement will be similar to a sale such that the fees will be recognised upfront. However, only one of the examples in IAS 18 refers to control as a key factor in determining the pattern of revenue recognition, and IAS 18 does not refer to exclusivity at all. It is likely therefore that the ED’s proposals would result in changes in practice in some cases.

In absence of any specific guidance under current IFRSs relating to recognising revenues on the sale of software, technology companies, especially software companies, typically have looked to guidance under other GAAPs, specifically US GAAP. US GAAP provides accounting guidance for software licensing arrangements that typically provide customers with perpetual or term (time-based) licences; whether a particular licence is exclusive or non-exclusive has no bearing on revenue recognition. Per the proposals of the ED, technology companies would have to determine based on the contract terms whether the contract provide customers with the right to use licences on an exclusive or non-exclusive basis.

ED BC224

Under the ED, the timing of revenue recognition would differ between contracts granting exclusive and non-exclusive rights to use the entity’s intellectual property during a licensing period. This is because the Board considers that an entity granting an exclusive right retains certain performance obligations towards the customer in the form of a requirement to refrain from doing something, i.e. not to grant the rights to another party during the exclusive licence period.

If the rights granted under the contract terms are not exclusive, which is the case for typical term-based software licences in which licences of the same software are granted to multiple customers, as well as perpetual licences that allow customers to use the software indefinitely, revenue would be recognised when the customer is able to use and benefit from rights (i.e. at the beginning of the licence period).

ED BC223

The Board proposes that the accounting for revenue arising from contracts granting exclusive rights without transfer of the entire licensed intellectual property be consistent with the accounting for revenue arising from a lease contract as discussed by the Boards under their joint project on lease accounting. However, the ED does not acknowledge the Boards' most recent discussions of the partial derecognition approach as an alternative to the performance obligation approach to lessor accounting.

6.5 Bill-and-hold arrangements

ED B58-B62

In a bill-and-hold arrangement, an entity bills a customer but does not ship the product until a later date, e.g. because of a lack of available space at the customer's premises or delays in production schedules. An entity would assess when the customer obtains control of the goods subject to a bill-and-hold arrangement in order to determine when to recognise revenue.

In most contracts the customer would obtain control upon delivery. Conversely, the customer would obtain control of the product before delivery if the arrangement meets all of the following conditions:

- the customer has requested the contract to be on a bill-and-hold basis;
- the product is identified separately as the customer's;
- the product is currently ready for delivery at the time and location specified or to be specified by the customer; and
- the entity cannot use the product or sell it to another customer.

If the entity evaluates that it is appropriate to recognise revenue in respect of a bill-and-hold arrangement, then it provides custodial services to the customer between the date of billing and the date of delivery. The entity considers whether the custodial services are a material separate performance obligation (see section 5.2) to which some of the transaction price should be allocated.

IAS 18.IE1(c)

Observations

Although the criteria to recognise revenue on a bill-and-hold basis are broadly similar in IAS 18 and in the ED, there are some differences in the detailed criteria. For example, IAS 18 requires that an entity's usual payment terms apply if the entity is to recognise revenue on a bill-and-hold basis.

Another condition under current IAS 18 to recognise revenue on a bill-and-hold basis is that it is probable that delivery will be made. In the ED, this is not stated explicitly but if it is not probable that delivery will be made, then it is likely that the contract does not exist for the purpose of applying the proposals in the ED.

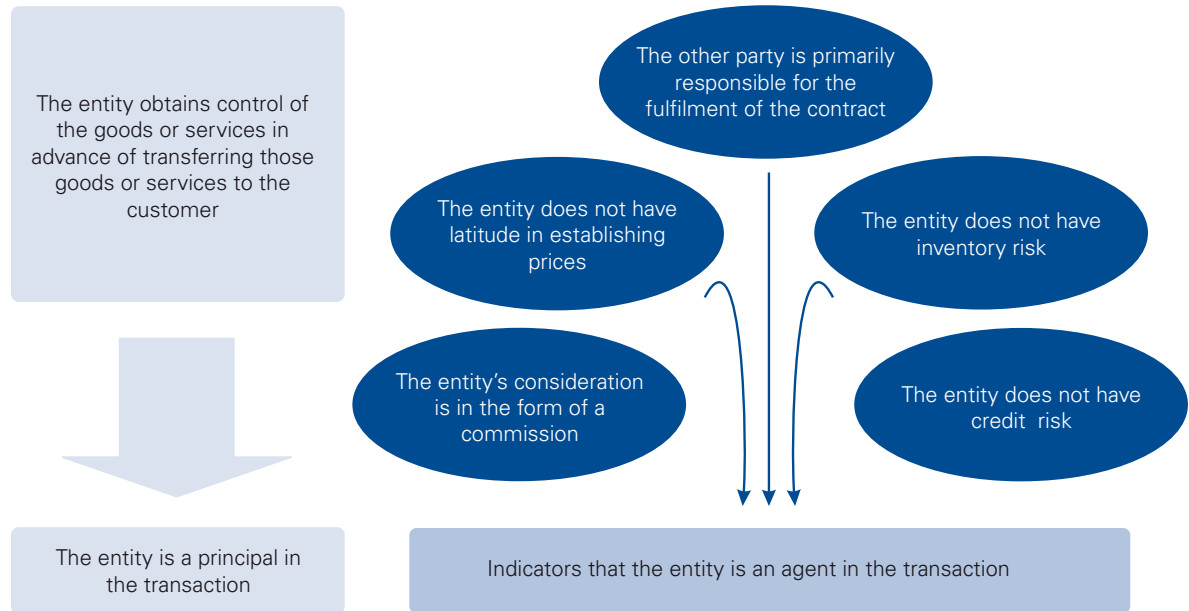
The fact that the entity pays for the cost of storage, shipment and insurance on the goods is also taken into account under current requirements to assess whether the significant risks and rewards of ownership of the products have passed to the customer. This analysis would no longer be relevant under the proposed requirements.

The proposal in the ED for it to be the customer that requests that delivery be delayed for the entity to recognise revenue on a bill-and-hold basis could prove a problematic basis for determining whether a sale has occurred in practice, given the focus on the intent of the other party to the transaction.

6.6 Agent vs principal

ED B20-B22

When other parties are involved in providing goods or services to an entity's customer, the entity determines whether it acts as a principal or an agent in the transaction. The ED proposes that this determination would be made as follows:



ED B20

If the entity is a principal, then revenue would be recognised on a gross basis. If the entity is an agent, then it would be recognised on a net basis.

Illustrative example – Agent vs principal

Company D provides internet-based college application services to assist applicants in applying for admission to colleges. Applicants can either access D's website directly or click through from the college's website to complete an application. Applicants electronically submit the completed application. Before accepting the application, D verifies the applicant's credit availability and charges the applicant's credit card. Once it is accepted by D, the application is transmitted to the college.

The contract with the colleges compensates D with a fixed fee, which D withholds from the admission fees collected. The colleges determine their own admission fee. If the applicant subsequently denies the credit card charge, D is at full risk of loss for the admission fee and remains obliged to remit the admission fee to the college.

After applying the indicators as proposed by the ED, it is reasonable for D to conclude that revenue should be reported for the net amount earned in the application transactions. This is because:

- D does not obtain control of the service promised by the colleges to the applicants, i.e. the college, and not D, is the party primarily responsible for fulfilling the performance obligation in the contract with the applicant, because the college is responsible for reviewing and accepting or denying applications; and
- D's remuneration is in the form of a commission; and
- D does not have latitude in establishing prices.

The fact that D does have credit risk in the transaction does not overturn the other indicators.

Observations

IAS 18.8

There is a similar principle in IAS 18 that the amounts collected on behalf of a third party are not revenue. However, determining whether the entity is acting as agent or principal is modified in the ED compared to IAS 18, as a result of the shift from the risks and rewards approach to the transfer of control approach. Under IAS 18, the entity is a principal in the transaction when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services.

IAS 18.IE21,
ED B22

In addition, the indicators in the ED are indicators of the entity being an agent whereas many indicators in IAS 18 are indicators of the entity being a principal.

At first glance, the proposals in the ED are not expected to change current accounting practice as it relates to agent versus principal determination for technology companies.

6.7 Consignment arrangements

ED B54-B57

In a consignment arrangement, an entity delivers goods to an intermediate party such as a dealer or distributor prior to onward sale to an end customer. At the date of delivery, the entity may retain title to the goods or the right to recover the goods or transfer them to another party.

ED B57

The ED also states that when a dealer or distributor sells a product from consignment inventory, it needs to consider whether it obtains control of that product before transferring it to its customer. If the dealer or distributor does not obtain control of the good, then it is an agent and recognises revenue net (see section 6.6).

Observations

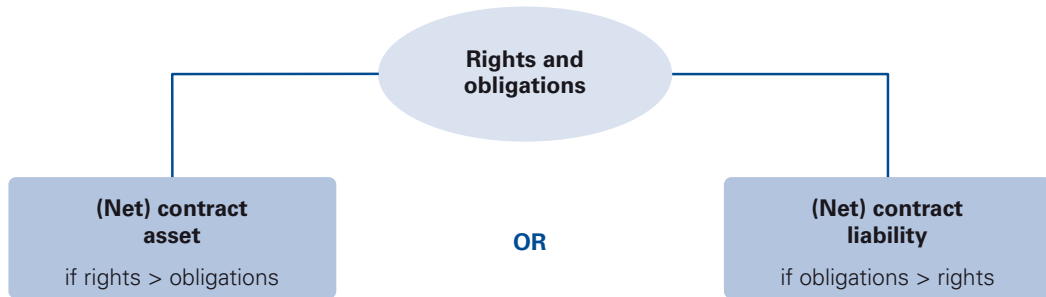
IAS 18.IE2(c)

These proposed requirements differ from the current guidance in IAS 18 insofar as they are based on the transfer of control approach whereas the IAS 18 requirements reflect a risks and rewards approach. These current requirements are discussed in our publication *Insights into IFRS* (4.2.160.10).

7. Presentation

ED 64, 65

The ED proposes that an entity present a contract asset or contract liability (i.e. the net asset or liability arising from the remaining rights and obligations in a contract) in its statement of financial position when either party to the contract has performed. The entity performs by transferring goods or services and the customer performs by paying consideration to the entity. The entity may also be required to present a contract liability as soon as the entity has an unconditional right to receive consideration.



Certain other assets and liabilities that arise during the life of a contract with a customer would be presented separately from the contract asset or liability, as follows:

ED 66

- An unconditional right to consideration would be presented as a receivable and accounted for in accordance with the requirements of the financial instruments standards. A right to consideration would be unconditional when nothing other than the passage of time is required before the consideration is due.

ED 67

- Costs capitalised in accordance with paragraph 57 of the ED (see section 5.6) would not be presented as part of the contract asset or liability but according to their nature.

ED 68

- Any liability recognised for an onerous performance obligation would be presented separately from any contract asset or contract liability.

Illustrative example – Presentation

ED B91

Company Z enters into an agreement with customer for the sale of a medical imaging device for 10,000 on 1 January.

Scenario 1 – Receivable

Z transfers the device to the customer on 31 March with payment due on 30 April.

On 31 March when Z transfers the device to the customer, the performance obligation is satisfied and an unconditional right to consideration is obtained. Z records the following entry:

	<i>Debit</i>	<i>Credit</i>
Receivable	10,000	
Revenue		10,000
<i>To recognise revenue and unconditional right to consideration</i>		

On 30 April when Z receives cash from the customer, it records the following entry:

	<i>Debit</i>	<i>Credit</i>
Cash	10,000	
Receivable		10,000
<i>To settle receivable</i>		

Scenario 2 – Contract liability

The agreement requires the customer to pay the consideration of 10,000 in advance on 31 January. The contract is non-cancellable. Z receives cash from the customer on 1 March and transfers the device to the customer on 31 March.

As the contract is non-cancellable, on 31 January Z obtains the unconditional right to consideration and records the following entry:

	<i>Debit</i>	<i>Credit</i>
Receivable	10,000	
Contract liability		10,000
<i>To recognise contract liability and unconditional right to consideration</i>		

On 1 March when Z receives cash from the customer, it records the following entry:

	<i>Debit</i>	<i>Credit</i>
Cash	10,000	
Receivable		10,000
<i>To settle receivable</i>		

On 31 March When Z transfers the device to the customer, the performance obligation is satisfied and Z records the following entry:

	<i>Debit</i>	<i>Credit</i>
Contract liability	10,000	
Revenue		10,000
<i>To recognise revenue and settle contract liability</i>		

Note: The time value of money and customer credit risk have been ignored for the purpose of this example.

Observations

IAS 11.42-44

Under current IFRSs, entities applying the percentage of completion method under IAS 11 present the gross amount due from customers for contract work as an asset, and the gross amount due to customers as a liability. For other contracts, entities present accrued/deferred income, or payments received in advance/on account, to the extent that payment is received before or after performance. The ED proposes a systematic approach to presentation in the statement of financial position.

ED 64, ED B91

An entity would present a contract asset or liability only *after* at least one party to the contract has performed. That is, generally no contract asset or liability would be presented on contract inception. This is consistent with other proposals in the ED regarding measurement, under which the costs of obtaining a contract are expensed as incurred and performance obligations are measured by reference to the transaction price, such that the carrying amount of a net contract asset/liability on contract inception would be nil.

The ED clarifies that certain items, e.g. capitalised costs, are not part of a contract asset or liability but does not otherwise state how such items would be presented in the statement of financial position.

The ED is silent on presentation of revenue in the statement of comprehensive income, though the section of the ED on onerous performance obligations notes that if a liability for an onerous performance obligation is remeasured, then remeasurement gains and losses would be presented separately from revenue.

8. Disclosure

ED 69 The ED proposes a range of disclosures intended to assist the users of financial statements to understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including disclosures about:

- contracts with customers; and
- the significant judgements and changes in judgements made in applying the proposals to those contracts.

ED 73-80 Proposed disclosures about contracts with customers include:

- a disaggregation of revenue for the period, in the manner that best depicts how the amount, timing and uncertainty of revenue and cash flows are affected by economic characteristics (e.g. by type of goods or services, type of contract, geography, market);
- reconciliations from the opening to the closing aggregate balance of contract assets and contract liabilities;
- reconciliations from the opening to the closing balance of the liability for onerous performance obligations; and
- information about performance obligations including a maturity analysis of remaining performance obligations for contracts expected to be completed after one year from contract inception.

ED 81-83 Proposed disclosures about significant judgements include the following:

Judgements in determining the timing of satisfaction of performance obligations	Judgements in determining the transaction price and allocating it to performance obligations
For performance obligations satisfied continuously, an entity would disclose: <ul style="list-style-type: none">● the methods used to recognise revenue (output method, input method); and● an explanation of why such methods faithfully depict the transfer of goods or services.	An entity would disclose the methods, inputs and assumptions used to: <ul style="list-style-type: none">● estimate the transaction price;● estimate stand-alone selling prices;● measure obligations for returns, refunds etc; and● measure the liability for onerous performance obligations.

ED B96 The ED proposes that if it is not practicable to disclose quantitative information about the inputs and assumptions used and their effect, then the entity would describe the methods, inputs, assumptions and estimates.

Observations

The proposed disclosures are significantly more extensive and detailed than the current requirements in IAS 18 and IAS 11. For instance, the following disclosure requirements would be new for preparers:

	New proposed disclosures	Observations
ED 75	Reconciliation of contract balances with revenue recognised during the period.	It may be challenging for some entities to identify the aggregate amounts to be included in the reconciliation when there are complex sales taxes that are included in receivables but excluded from revenue.
ED 77(a)	Disclosures about any performance obligations when the entity acts as an agent.	In our experience, few entities currently disclose such detailed information.
ED 78	For contracts expected to be completed after one year from contract inception, the amount of the transaction price allocated to the performance obligations remaining at the end of the reporting period and scheduling of the related revenue recognition.	The ED proposes fixed time bands for this analysis. This is not entirely consistent with the requirements in current standards when prospective analysis is required: some standards require judgement to determine the time bands (e.g. liquidity-risk maturity analysis of financial liabilities in paragraphs 39(a) and 39(b) of IFRS 7 <i>Financial Instruments: Disclosures</i>), while others require information on the next five years (e.g. paragraph 56 of IAS 17 for future minimum lease payments expected by lessors).
ED 79	For onerous performance obligations, the reasons why the performance obligations became onerous and the period during which the entity expects to satisfy the liability.	This is more detailed than the current disclosure requirements in paragraph 85(a) of IAS 37.
ED 72	Requirement to take into account disclosure requirements on revenue in other standards to disclose information as required in the ED.	The way in which entities disclose entity-wide disclosures in accordance with paragraphs 31 to 34 of IFRS 8 <i>Operating Segments</i> could for instance affect the disclosure requirements in the ED.

The proposed reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities would be presented on a net basis. In proposing that the reconciliation be presented on a net basis, the Boards are seeking to balance the views of preparers and users of financial statements. Presentation on a net basis may ease the burden on preparers, but also may reduce the usefulness of the disclosure to users of financial statements.

9. Effective date and transition

ED 84, BC236 The ED does not specify an effective date for the new standard. This is because the Board plans to issue a separate consultation document on the effective dates of this and other new standards scheduled to be completed in 2011.

ED 85 The ED proposes that the amendments be applied retrospectively, in accordance with IAS 8.

Observations

ED BC231 Full retrospective application of the new standard would ensure consistent application of the revenue recognition model to all IFRS issuers and to all transactions of the same nature by an entity. However, full retrospective application of the new standard might require significant historical analyses to be prepared, and could be a substantial undertaking especially for entities with long-term contracts.

ED BC238 The ED does not state whether early application of the new standard would be permitted. However, it notes that the IASB would prefer that first-time adopters of IFRSs be permitted to adopt the new standard early, to avoid requiring first-time adopters to change their accounting policy for revenue shortly after the adoption of IFRSs.

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