

IFRS 15 *Revenue from Contracts with Customers*

YOUR QUESTIONS ANSWERED

March 1, 2015

IFRS

IN COLLABORATION WITH:

Deloitte.

IFRS 15 *Revenue from Contracts with Customers*

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Notice to Reader

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Introduction

In November 2014, CPA Canada, in collaboration with Deloitte delivered a webinar on IFRS 15 *Revenue from Contracts with Customers* (IFRS 15).

The one-hour webinar provided a general overview of IFRS 15, discussed some key changes from current accounting practices, highlighted some industry-specific considerations and suggested a general plan of action, including operational considerations.

To access this free webinar, visit www.cpacanada.ca or click [here](#).

This publication has been developed by CPA Canada in collaboration with Deloitte to address some of the unanswered questions posed by participants during the webinar as well as other common questions. Members in industry implementing IFRS 15 and members in practice who are working with their clients through the implementation process will find this document particularly useful.

The responses provided are narrow and limited in scope and are not a substitute for careful analysis of entity-specific facts and circumstances.

The questions contained within this document are organized by the following topic areas:

- **Scope**
- **Step 1—Identify the contract(s) with a customer**
- **Step 2—Identify the performance obligations in the contract**
- **Step 3—Determine the transaction price**
- **Step 4—Allocate the transaction price to the performance obligations in the contract**
- **Step 5—Recognize revenue when (or as) the entity satisfies a performance obligation**
- **Contract costs**

- [Specific application considerations](#)
- [Transition](#)
- [Presentation](#)
- [Disclosure](#)
- [Application Resources](#)

This publication has been developed as of March 1, 2015. Subsequent discussions may have taken place (i.e., by the Transition Resource Group (TRG) or by the IASB) that have not been incorporated into this publication.

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)



The TRG is a group including financial statement preparers, auditors and users who have significant knowledge and experience with revenue recognition and who solicit, analyze, and discuss stakeholder issues related to IFRS 15 or its U.S. GAAP equivalent ASU 2014-09 (Topic 606).

The purpose of the TRG is not to issue guidance but instead to seek and provide feedback on potential issues related to implementation of IFRS 15/ASU 2014-09 (Topic 606). By analyzing and discussing potential implementation issues, the TRG will help the IASB and FASB determine whether they need to take additional action, such as providing clarification or issuing other guidance.

To learn more about the TRG refer to question 30.

To download audio recordings or meeting reports of agenda topics visit www.ifrs.org or click [here](#).

Background

In May 2014, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) jointly issued *Revenue from Contracts with Customers* (IFRS 15 under IFRS and ASU 2014-09 (Topic 606) under U.S. GAAP), a converged¹ standard on the recognition of revenue from contracts with customers. IFRS 15 supersedes existing standards² and interpretations³ related to revenue and is mandatorily effective for annual periods beginning on or after January 1, 2017, with earlier application permitted under IFRS.⁴ IFRS 15 is to be applied retrospectively using either a full retrospective approach (subject to certain practical expedients) or a modified retrospective approach.

IFRS 15 establishes a comprehensive framework for recognition of revenue from contracts with customers based on a core principle that an entity should recognize revenue representing the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The scope of IFRS 15 applies to *all* contracts with customers in *all* industries, with the exception of:

- lease contracts (within scope of IAS 17 *Leases*)
- insurance contracts (within the scope of IFRS 4 *Insurance Contracts*)
- financial instruments and other contractual rights or obligations (within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*)⁵

¹ Within minor differences; Appendix A of the *Basis for Conclusions* of IFRS 15 summarizes these differences. Refer to question 29 for further details.

² IAS 18 *Revenue* and IAS 11 *Construction Contracts*

³ 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*.

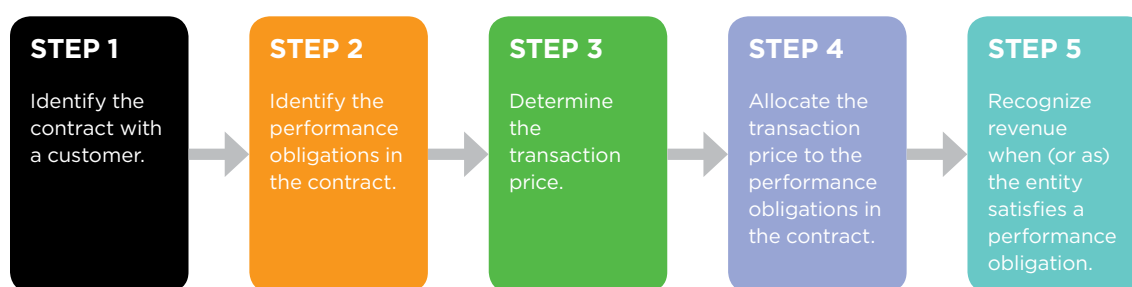
⁴ In April 2015, the IASB voted to publish an Exposure Draft proposing a one-year deferral of the effective date to January 1, 2018, with early application permitted.

⁵ Certain financial instruments and contractual rights or obligations may also fall under the scope of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*. These are also excluded from the scope of IFRS 15.

- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Unlike current revenue guidance (under IFRSs), IFRS 15 also specifies the accounting for the incremental costs of obtaining a contract with a customer and the costs incurred to fulfill a contract with a customer.

IFRS 15 introduces a five-step model for revenue recognition that focuses on the “transfer of control” rather than the “transfer of risks and rewards”. The five-step model is as follows:



Responses to Questions

Scope

1. Scope

What is the scope of IFRS 15?

The first decision an entity needs to make is to determine whether the particular arrangement /contract / transaction is within the scope of IFRS 15. The scope of IFRS 15 applies to all contracts (subject to the exceptions listed below) provided the counterparty to the contract is a customer. IFRS 15 defines a customer as “...a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration”. Although determining whether the contract is, in fact, with a customer may seem simple conceptually, in practice it may be challenging for different types of contracts (e.g., collaborative arrangements (discussed further below), production-sharing contracts, concession agreements and other similar risk-sharing contracts).

All contracts (defined as an agreement between two or more parties that creates enforceable rights and obligations) with customers are within the scope of IFRS 15, subject to these specific exceptions:

- lease contracts within the scope of IAS 17 *Leases*
- insurance contracts within the scope of IFRS 4 *Insurance Contracts*
- financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments* (IAS 39 *Financial Instruments: Recognition and Measurement*), IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*

- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, IFRS 15 does not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

Consider the following types of transactions:

- **Collaborative Arrangements**

In collaborative arrangements, it is not always clear whether a customer exists and therefore whether the transaction/arrangement is within the scope of IFRS 15. Collaborative arrangements are those whereby the counterparty in the arrangement may be a collaborator or partner that shares in the risks and benefits of a particular activity and are common in the life sciences, biotech, and oil and gas sectors, among others.

The specific facts and circumstances surrounding each arrangement will have to be carefully analyzed and assessed and a determination will have to be made on a case-by-case basis for such arrangements since IFRS 15 does not provide more specific guidance on the definition of a customer, and application thereof.

- **Non-Monetary Exchanges**

Non-monetary exchanges must also be carefully assessed when considering scope since certain non-monetary exchanges will be in scope while others will be out of scope. Under existing IFRSs guidance, non-monetary exchanges that were an exchange of goods or services of a similar nature were scoped out of the revenue standards.

Under IFRS 15, non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers are scoped out.

Therefore, determining whether certain non-monetary exchanges are within the scope of IFRS 15 could require judgment and will depend on the facts and circumstances of the arrangement. If scoped into IFRS 15, such exchanges are subject to all the requirements of IFRS 15.

- **Related-Party Transactions**

To the extent that a related party meets the definition of a customer (i.e., a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration) and the transaction is within the scope of the standard, IFRS 15 would apply.

Step 1—Identify the Contract(s) with a Customer

2. Collectability

One of the five criteria⁶ that must be met for a contract to exist is that it is probable the entity will collect the consideration to which it is entitled. What does this mean and how is this applied?

The inclusion of a collectability requirement in the identification of a contract incorporates an evaluation of the customer's credit risk in determining whether a contract is, in fact, valid (i.e., whether it is probable that the consideration to which the entity is entitled in exchange for the goods or services will be collected).

As a reminder, “probable” under IFRSs is regarded as “more likely than not to occur”.⁷ Introducing such a threshold requires entities to consider whether a contract is valid and represents a genuine transaction. Although this determination is subjective and requires judgment, IFRS 15 does provide guidance noting that this assessment is completed from the perspective of whether the customer has the “ability and intention” to pay the amount of consideration to which the company expects to be entitled.

Questions have arisen in practice as to how the above guidance interacts with price concessions offered to a customer. Price concessions are referred to in Step 3 of the revenue model (determining the transaction price) and are a form of variable consideration. Offering a price concession to a customer does not necessarily imply the consideration is not “collectible”; it simply changes the total amount of consideration to which an entity expects to be entitled. An analysis of expected price concessions must often be made first in order to determine the consideration to which the entity expects to be entitled. Once

6 All five criteria are as follows: 1) the parties have approved the contract and are committed to perform their respective obligations, 2) the entity can identify each party's rights regarding the goods or services to be transferred, 3) the entity can identify the payment terms for the goods or services to be transferred, 4) the contract has commercial substance, and 5) it is probable that the entity will collect the consideration to which it will be entitled to in the exchange. [IFRS 15.9]

7 Note—this threshold is different under US GAAP, however in completing IFRS 15, the Boards noted that most entities would not enter into a contract with a customer where there is significant credit risk and therefore there would not be a significant practical effect of the differing meaning of the same term.

the amount of consideration is determined (even if variable because of a price concession) then this consideration should be assessed in the context of a customer's ability and intention to pay.

Determining whether collectability is probable is a very important assessment under IFRS 15. If this criterion is not met, then revenue cannot be recognized (effectively precluding the use of the cash basis of accounting) and any consideration received is recorded as a liability (e.g., unearned revenue) until either of the following events has occurred:

- The entity has no remaining performance obligations *and* all or substantially all the consideration for the performance obligations in the contract has been received and is non-refundable [IFRS 15.15(a)].
- The contract is terminated and the consideration received is non-refundable [IFRS 15.15(b)].

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)



The topic of collectability was discussed by the TRG at its January 2015 meeting. Specific questions brought to the attention of the TRG were:

- How should an entity assess collectability for a portfolio of contracts?
- When should an entity reassess collectability?
- How should an entity recognize revenue on contracts that are subsequently reassessed as not probable of collection (i.e., after being assessed as collectible at the beginning of the contract)?
- How should an entity assess whether a contract includes a price concession?

Stakeholders should monitor developments on this issue.

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Step 2—Identify the Performance Obligations in the Contract

3. Promised Goods or Services

IFRS 15 refers to a “performance obligation” as a promised good or service (i.e., promise in a contract) that is distinct. How should a promised good or service be identified?

A contract includes both explicitly and implicitly promised goods or services. An implicit promise is inferred from an entity's customary business practices, published policies, specific statements, etc. and creates a valid expectation in the customer that there will be a transfer of a good or service to them.

In identifying a promised good or service, judgment is required. For example, if an item or activity provides something of benefit to a customer, even if minor, should this be a “promised good or service” for the purposes of determining whether this is a performance obligation? The Basis for Conclusions on IFRS 15 specifies that “...all goods or services promised to a customer as a result of a contract give rise to performance obligations because those promises were made as part of the negotiated exchange between the entity and its customer”. Furthermore the Basis for Conclusions on IFRS 15 specifies that entities are “...not exempt from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity should assess whether those performance obligations are immaterial to its financial statements”.

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)

IASB Discussions



The topic of identifying promised goods or services in a contract was discussed by the TRG at its January 2015 meeting. The specific question brought to the attention of the TRG was:

- What are the promised goods or services in a contract with a customer?

The following examples of potential promised goods or services (as raised by stakeholders) were brought to the attention of the TRG:

- a requirement to stand ready to answer questions about a consumer product because that product includes a helpline telephone number for customer questions or complaints about the product
- a promise by the entity to deliver periodic account statements to the customer
- a promise to deliver additional copies of licensed intellectual property (for example, a promise to deliver 10 additional copies of software or media content to the customer beyond the initial copy that makes available the intellectual property for the customer's use).

This topic was further discussed by the IASB at its February 2015 meeting.⁸ The IASB decided that additional guidance was not required as to whether an entity is required to identify goods or services promised to the customer that are immaterial in the context of the contract.⁹

To download audio recordings or meeting reports of agenda topics visit www.ifrs.org or click [here](#).

⁸ Note—This was a joint Board meeting with the FASB.

⁹ Note—The decisions made by the IASB were not necessarily the same as those of the FASB.

4. Identifying Performance Obligations

How should an entity determine whether a promise is a distinct performance obligation and should be accounted for separately or whether it should be bundled with other promises to be included in the application of the remaining steps of the model?

Once all promised goods or services either explicit or implicit in the contract are identified, an assessment must be completed as to whether these goods or services are performance obligations.

In order to assess what constitutes a performance obligation, a determination must be made as to whether:

- the good or service is distinct [IFRS 15.22(a)]
- the good or service is part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer [IFRS 15.22(b)].

In identifying performance obligations, judgment is again required. IFRS 15 notes that activities that must be undertaken to fulfill a contract (e.g., various administrative tasks) but do not result in a transfer of goods or services are not a promised good or service for the purpose of identifying performance obligations. IFRS 15.26 provides some examples of distinct goods and services.

Good or Service Is Distinct

IFRS 15 provides two very specific criteria that must *both* be met in order for a good or service to be considered distinct:

- the customer must be able to benefit from the good or service either on its own or together with other readily available resources (i.e., capable of being distinct) [IFRS 15.27(a)]
- the good or service is separately identifiable from other goods or services in the contract (i.e., distinct within the context of the contract) [IFRS 15.27(b)].

Factors that indicate a customer may be able to benefit from a good or service on its own or together with other readily available resources, include, the good or service can be:

- used, consumed, or sold for an amount greater than scrap value
- held in a way that generates economic benefits.

The above can be achieved either by holding the good or receiving the service on its own (i.e., benefiting from the good or service on its own) or through the use of other readily available resources (i.e., benefiting from the good or service in conjunction with other readily available resources). A readily available

resource is one that is generally sold separately. If a good or service is regularly sold separately this is also an indicator that the customer can benefit from this good or service on its own or with other readily available resources.

Factors that indicate an entity's promise to transfer a good or service to a customer is separately identifiable include, but are not limited to, the following:

- The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted. In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer [IFRS 15.29(a)].
- The good or service does not significantly modify or customize another good or service promised in the contract [IFRS 15.29(b)].
- The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract [IFRS 15.29(c)].

EXAMPLE: IDENTIFYING DISTINCT GOODS



A bus manufacturer offers for sale both fully manufactured buses and spare parts.

When a customer purchases a fully manufactured bus, it is made up of many inputs (e.g., engine, tires, frame, etc.); however, the customer is not receiving these individual inputs (e.g., the engine in isolation). Rather, these inputs are used to produce a combined output to the customer (i.e., a bus). Although engines may be sold separately as a spare part, which would indicate that it meets the first criterion of being a distinct good (i.e., capable of being distinct), in the context of a contract for a fully manufactured bus the engine is not considered distinct because it is an input and the entity is providing a significant service by integrating the engine with other goods and services in the contract (i.e., the engine is not distinct within the context of the contract).

Therefore in this type of contract, the engine is not considered to be a distinct good or service, and is not a separate performance obligation.

MONITOR DEVELOPMENTS

IASB Discussions



The topic of identifying performance obligations was discussed by the IASB in its February 2015 Board meeting.¹⁰ The IASB decided to add some illustrative examples to IFRS 15 to clarify how the IASB intended the guidance on identifying performance obligations to be applied. Stakeholders should monitor developments on this issue.¹¹

¹⁰ Note—This was a joint Board meeting with the FASB.

¹¹ Note—The decisions made by the IASB were not necessarily the same as those of the FASB.

The Good or Service Is Part of a Series of Distinct Goods or Services

This requirement aims to simplify the application of the five-step model in situations where an entity is providing substantially the same good or service over a period of time. For this requirement to apply, two specific criteria must be met:

- Each distinct good or service transferred in the series must meet the criterion for a performance obligation satisfied “over time” (discussed later) [IFRS 15.23(a)].
- The same method is used to measure progress toward satisfaction of the performance obligation to transfer each distinct good or service in the series [IFRS 15.23(b)].

EXAMPLE: SERIES OF DISTINCT GOODS



A manufacturer enters into a contract with a customer to provide a series of similar customized goods in a large quantity that will be delivered consecutively over time. Based on the contract, the customer has title to and controls the work in progress as the products are being manufactured. The manufacturer has determined an expected average cost for manufacturing the product and

has also determined that using an input method based on costs (for this particular contract) is an appropriate method because it represents the manufacturer’s performance when transferring control of the goods.

This contract is determined to be for a series of distinct goods that are effectively *one performance obligation* because of the following:

- The goods are similar in nature and are transferred consecutively over time (i.e., over a period of XX years).
- The contract is satisfied over time because the customer has title to and controls the work in progress while the products are being manufactured and therefore meets the criterion for over-time recognition.
- The same method (i.e., cost to cost) is used to measure progress toward the satisfaction of the performance obligation of each individual product.

Given that the series criteria is met, the entity must account for the series as one performance obligation. This is not optional. Accounting for a series of distinct performance obligations as opposed to one performance obligation may result in different accounting consequences. It is also important to note that if such contracts include variable consideration or contract modifications, the related guidance is applied at the level of the individual distinct goods or services and not at the series level.

5. Distinct within the Context of the Contract

What is the impact of sub-contracting work on the identification of performance obligations? For example, assume that a vendor is offering a number of goods or services in a contract, and these are being offered as one solution to the customer. However, some of the individual goods or services required to create the customer solution can be sub-contracted out by the vendor.

The sub-contracting of services may not result in a change in the assessment of whether a good or service is distinct. In the Basis for Conclusions on IFRS 15, the Boards specifically noted that construction-type and production-type contracts involve the transfer to the customer of many goods and services that are capable of being distinct (such as various building materials, labour or services and project management services). However, identifying each individual good or service as a promise would not faithfully represent the nature of the entity's promise to the customer nor result in a useful depiction of the entity's performance.¹²

EXAMPLE: SUBCONTRACTING SERVICES



A building contractor enters into a contract with a customer to build a residential home. Various goods and services are required throughout the construction process.

As is typical with construction projects,¹² the various goods and services are subject to significant integration such that the customer is in effect getting a single output and the entire contract is viewed as one performance obligation.

Assume in this particular case, the builder is not completing all the required services needed for the combined output to satisfy the customer on its own. The building contractor sub-contracts out the electrical and plumbing work to an external, independent contractor. Does contracting out some of the services change the assessment such that the contract is no longer one performance obligation? Does the ability to sub-contract services mean the services are distinct performance obligations?

In this case, although the electrical and plumbing services are being obtained elsewhere (i.e., capable of being distinct), the building contractor is still providing a level of integration as the nature of the promise is to produce a combined output (i.e., a residential home).

The sub-contracting of services would not result in a change in the assessment of whether a good or service is distinct.

As both criteria (i.e., capable of being distinct and distinct within the context of the contract) for identifying a good or service as distinct were not met, the entire contract remains as one-performance obligation.

¹² Note—Individual facts and circumstances will always have to be assessed.

These subcontracting arrangements should still be assessed from the perspective of agency relationships (i.e., the subcontractor acting effectively as an agent). The principal/agent considerations noted in Appendix B of IFRS 15 should be considered. Appendix B, specifically notes:

An entity that is a principal in a contract may satisfy a performance obligation by itself or it may engage another party (for example, a subcontractor) to satisfy some or all of a performance obligation on its behalf. When an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for those goods or services transferred.

Therefore, as long as the entity remains a principal,¹³ engaging another party to transfer some goods or services, does not change the identification of performance obligations.

Step 3—Determine the Transaction Price

6. Variable Consideration

What is meant by variable consideration?

Variable consideration encompasses any amount that is variable under a contract, including, for example, performance bonuses, penalties, discounts, rebates, price concessions, incentives and the customer's right to return products.

Variable consideration is considered to be a component of the transaction price. It is part of the consideration to which an entity expects to be entitled in exchange for transferring promised goods or services and therefore should be estimated and included in the transaction price for revenue recognition purposes.

When the consideration receivable is variable, the entity must estimate the amount of the consideration using either the expected value (i.e., a probability-weighted amount) or the most likely amount, depending on which method better predicts the amount of consideration.

Some or all of the estimated amount of variable consideration is included in the transaction price but only to the extent that it is highly probable a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

¹³ Note—Not all sub-contractor relationships will result in the entity remaining the principal. An assessment of the specific facts and circumstances surrounding the particular relationships and terms will always be required.

If the consideration promised in a contract has an element of variability, whether it be explicitly stated in the contract or customers have a valid expectation (e.g., inferred from customary business practices) the entity will accept an amount lower than that stated in the contract, or there is an intention to offer a price concession to a customer, then the contract is considered to include “variable consideration” for the purposes of applying IFRS 15.

EXAMPLE: VOLUME DISCOUNT



On January 1, 20XX, an entity (with a December 31 year end) enters into a contract with a customer for the sale of a product for total consideration of \$100/unit for a one-year period. If the customer purchases more than 75 units of this product, the total consideration will be \$80/unit retrospectively applied (i.e., all purchases will be at \$80/unit). Initially, the entity does not believe the customer will purchase more than 75 units. However, on May 20, 20XX, the entity infers from the customer's purchasing pattern that the customer will in fact meet this target. Assume that the purchase pattern is as follows:

January	10 units
February	15 units
March	15 units
May 20	12 units

Because the total contract consideration of \$100/unit includes a fixed component (i.e., \$80/unit) and a variable component (i.e., \$20/unit), the variable component must be assessed to determine the estimated value and whether this amount should be constrained. Consider the following:

- Contract Inception**
 Based on past history (that has predictive value) with this particular product and the customer, the entity does not believe the customer will meet the target required for the consideration to drop to \$80/unit. The entity believes instead there is a high probability a significant revenue reversal will not occur because the target expected purchases will *not* exceed 75 units and therefore the entity expects to be entitled to consideration of \$100/unit rather than \$80/unit. The entity records the total consideration amount of \$100/unit.

EXAMPLE: VOLUME DISCOUNT

- **March 31, 20XX**
If the conclusions reached at inception remain appropriate, revenue for the period ending March 31, 20XX will be recognized using the \$100/unit price.
- **May 20, 20XX**
The entity now estimates that because of increased purchases the customer will likely exceed the targeted 75 units. It is now highly probable a significant revenue reversal will occur. Therefore revenue will have to be retrospectively adjusted to the \$80/unit price. This adjustment will be recorded in the current period, meaning May 20XX (i.e., in Q2).

Time Period	Amount of Revenue to Be Recognized	
January — March	\$4,000	= (10+15+15 units) × \$100/unit
May 20	\$160	= (10+15+15 units) × (\$80/unit-\$100/unit) ¹⁴ + (12 units) × \$80/unit

Consideration Payable to a Customer

Another factor that must be considered when determining the transaction price is “consideration payable to a customer”.

Consideration payable to a customer may constitute a payment for distinct goods or services, or payment of a discount or refund. Some common examples include coupons, vouchers, signing bonuses, slotting and listing fees, etc. This type of consideration must be accounted for as a reduction of the transaction price (and therefore revenue), unless it is related to a distinct good or service received from the customer, in which case there is no reduction of the transaction price and the transaction would be treated as a regular purchase similar to any other external third-party purchase. Additionally, if this amount is variable when determining the transaction price, the variable consideration constraint must be assessed.

¹⁴ Change in transaction price for the reduction of revenue

MONITOR DEVELOPMENTS

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The topic of consideration payable to a customer was discussed by the TRG at its January 2015 meeting. Specific questions/topics brought to the attention of the TRG were:

- Are entities required to apply the guidance on consideration payable to a customer at the contract level or more broadly to the entire “customer relationship”?
- The guidance refers to payments made to a customer or “to other parties that purchase the entity’s goods or services from the customer”. Is this guidance meant to apply only to customers in the distribution chain or more broadly to any customer of an entity’s customer?
- What is the correct timing of recognizing consideration payable to a customer that is anticipated, but not yet promised, to the customer?
- Should “negative revenue” (consideration payable exceeds consideration to be received) be reclassified to an expense?

Stakeholders should monitor developments on these issues.

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7. Significant Financing Component

IFRS 15 has specific requirements when it comes to a “significant financing component”. How is this assessed?

The objective when adjusting the promised amount of consideration for a significant financing component is that revenue recognized should reflect the “cash selling price” of the particular good or service at the time the good or service is transferred.

Contracts in which payment by the customer and performance by the entity occur at significantly different times will need to be assessed to determine whether the contract contains a significant financing component.

In assessing whether a significant financing component exists, IFRS 15 requires an assessment of the relevant facts and circumstances. Factors that should be considered in this assessment include *both* of the following:

- a. the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services [IFRS 15.61(a)]; and
- b. the combined effect of both of the following [IFRS 15.61(b)]:
 - i. the expected length of time between when the entity transfers the promised goods or services to the customer and when the customer pays for those goods or services; and
 - ii. the prevailing interest rates in the relevant market.

EXAMPLE: ADVANCE PAYMENT AND ASSESSMENT OF DISCOUNT RATE



Source

Illustrative Example 29
IFRS 15 Revenue from Contracts with Customers



This example accompanies, but is not part of, IFRS 15. This example illustrates aspects of IFRS 15 but is not intended to provide interpretative guidance.

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

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

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

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

1. recognize a contract liability for the CU4,000 payment received at contract inception:
 Cash CU4,000
 Contract liability CU4,000
2. during the two years from contract inception until the transfer of the asset, the entity adjusts the promised amount of consideration (in accordance with paragraph 65 of IFRS 15) and accretes the contract liability by recognizing interest on CU4,000 at six per cent for two years:
 Interest expense CU494*
 Contract liability CU494
3. recognize revenue for the transfer of the asset:
 Contract liability CU4,494
 Revenue CU4,494

*CU494 = CU4,000 contract liability × (6% interest per year for two years).

However, entities may still encounter a situation in which both the above factors exist, but nevertheless may conclude that a significant financing component does not exist. In order for this to be the case, at least one of the following factors must be present:

- a. the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer (for example, in the telecom industry, when a customer purchases a prepaid phone card) [IFRS 15.62(a)].

- b. a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration varies on the basis of the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty) [IFRS 15.62(b)].
- c. the difference between the promised consideration and the cash selling price of the good or service arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference (for example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract) [IFRS 15.62(c)].

PRACTICAL EXPEDIENT!



As a practical expedient, an entity need not adjust the transaction price in a contract for the effects of a significant financing component, if the period between when the customer pays for the good or service and when the entity transfers the good or service is one year or less.

Entities must apply the use of practical expedients consistently to contracts with similar characteristics and in similar circumstances.

EXAMPLE: DETERMINING IF A SIGNIFICANT FINANCING COMPONENT EXISTS



A consulting engineering firm enters into a two-year contract to provide consulting services to a builder for electrical work in a new multi-billion-dollar commercial complex.

As part of the contract, the builder will make payments to the consultant at certain milestones in the contract. Assume the engineering firm has concluded this contract is one performance obligation to be satisfied over time. Assume the milestone payments have been scheduled to coincide with performance.

10% of each milestone payment will be withheld by the builder and paid once all consulting work is completed and all electrical work in the complex is operational.

The engineering firm concludes that, although there is effectively a delay between performance and payment (i.e., related to the holdback), the delay is for reasons other than financing (i.e., the holdback is intended to protect the builder from the engineering firm failing to complete its obligations under the contract) and the amount of the holdback is proportionate to this intended reason.

However, if the contract resulted in the builder making a payment of 50% of the total contracted amount at inception, would a significant financing component now exist?

Given that the services will be provided throughout the two-year contract period and not at inception, the payment will no longer coincide with performance. This means the entity will be required to assess whether a significant financing component is present.

MONITOR DEVELOPMENTS

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The topic of a significant financing component was discussed by the TRG at its January 2015 meeting. Specific questions brought to the attention of the TRG were:

- Should the factor in IFRS 15 paragraph 62(c) be applied broadly?
- If the implied interest rate in an arrangement is zero (i.e., interest free financing) such that the consideration to be received is equal to the cash selling price, does a financing component exist?
- How should an entity adjust for the time value of money in situations where the consideration is received upfront and revenue is recognized over multiple years?

Stakeholders should monitor developments on this issue.

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Interest income or interest expense resulting from a significant financing component should be presented separately from revenue from contracts with customers. An entity might present interest income as revenue in circumstances in which interest income represents income from an entity's ordinary activities.

8. Sales with a Right of Return

How are sales returns accounted for under IFRS 15?

Sales returns are a form of variable consideration. IFRS 15 provides specific guidance for this form of variable consideration.

Entities in many industries (e.g., retail, industrial products, consumer products, etc.) often grant customers a right of return with purchased goods, which may result in one of the following:

- a full or partial refund of any consideration paid
- a credit applicable to amounts owed, or that will be owed, to the entity
- another product in exchange (e.g., "stock rotation rights").

Under IFRS 15, when sales are made to customers with a right of return, the selling entity will need to account for them as follows:

- a. Recognize revenue for the consideration to which the entity expects to be entitled. In making this assessment, entities must apply the guidance on variable consideration, including the constraint. Therefore, for the goods the entity estimates are going to be returned, no revenue is recognized (i.e., because it is highly probable that a significant revenue reversal will occur), rather a refund liability is recognized (refer to step 2 below).
- b. Set up a liability for the amount of consideration the entity expects it will have to refund (i.e., products expected to be returned).

- c. Set up an asset with a corresponding entry to cost of sales for the right to recover products when a refund liability is settled (i.e., this will be at the cost of the initial inventory less any expected costs to recover the products).

EXAMPLE: ACCOUNTING FOR PRODUCT RETURNS



A retailer has a stated policy that any products may be returned within 30 days subject to a cap of 20% (i.e., only up to a maximum of 20% of goods purchased may be returned within the 30 day window).

On January 1, 20XX, the retailer introduced a new product with a carrying value of \$35 in inventory. The following return patterns occurred during the next three months:

January	1% returned
February	19% returned
March	5% returned

On April 1, 20XX, the retailer enters into a new contract and sells 150 units of this new product at a price of \$50/unit. However, given that the product has been newly introduced to the market and there is a large range of possible consideration amounts (i.e., as evidenced by the pattern of returns over the last few months), the retailer is unable to assert that it is highly probable a significant revenue reversal will not occur for the variable component (i.e., the 20%). Therefore this variable consideration (i.e., 20% of the transaction price subject to return) cannot be recognized until May 1, 20XX, when the 30-day right of return lapses and the following entries will be made:

Time Period	Entries	DR	CR
	Dr Asset (right to recover product)	\$1,050	
	Dr Cost of Sales	\$4,200	
	Cr Inventory		\$5,250
April 1, 20XX	Dr Cash	\$7,500	
	Cr Refund Liability		\$1,500
	Cr Revenue		\$6,000
	<i>As sales of the product occur.</i>		
	Dr Refund Liability	\$1,500	
	Cr Revenue		\$1,500
May 1, 20XX	Dr Cost of Sales	\$1,050	
	Cr Asset (right to recover product)		\$1,050
	<i>When the 30-day refund period lapses (assuming no returns).</i>		

9. Non-Cash Consideration

What are the requirements for accounting for non-cash consideration under IFRS 15?

Under existing IFRSs, IFRIC Interpretation 18 *Transfers of Assets from Customers* (IFRIC 18) and SIC Interpretation 31 *Revenue—Barter Transactions Involving Advertising Services* (SIC 31) are the interpretations (as well as IAS 18.9-12 on a broader level) that provide some guidance on non-cash consideration (noting that this guidance is specific to certain types of transactions and not all non-cash transactions).

Upon adoption of IFRS 15, this guidance will be superseded, and the specific guidance in IFRS 15 related to non-cash consideration will have to be applied.

IFRS 15 requires that non-cash consideration received be measured at the fair value of the consideration received. If fair value cannot be reasonably estimated, the consideration will be measured by reference to the stand-alone selling price of the good or service promised in the contract.

The fair value of non-cash consideration may vary. If the non-cash consideration varies for reasons other than the form of the consideration, entities will apply the guidance in IFRS 15 related to constraining variable consideration. However, if fair value varies only due to the form, the variable constraint guidance in IFRS 15 would not apply.

Consider the following:

Non-cash Consideration	Variability Due to Form of Consideration	Variability Due to Other Than Form of Consideration
Share options	Change in share price	Change in exercise price (due to performance)

EXAMPLE: NON-CASH CONSIDERATION



A technology company has recently encountered some cash flow difficulties. However, the company believes a new division of operations will fix this issue. In order to commence operations in this new division, the company requires certain software licences, which its regular software vendor agrees to provide. However, rather than receiving a cash consideration for the licences, the software vendor agrees to receive 1,000 shares of the common stock of the technology company, which they will receive in 60 days when payment is due.

EXAMPLE: NON-CASH CONSIDERATION



Given the nature of the non-cash consideration (e.g., common stock), the value will naturally vary due to changes in the market price of the shares. In this case, the variation is due to the form of the consideration and the constraint on variable consideration is not applicable. However, fair value must still be determined.

When determining fair value of this non-cash consideration, at what point in time should this value be determined (i.e., what price should be multiplied against the 1,000 units to determine fair value)? IFRS 15 is silent on when non-cash consideration should be measured. Alternatives to consider include:

- the share price at contract inception
- the share price when the non-cash consideration is received (or receivable)
- the share price at the earlier of the date the non-cash consideration is received (or receivable) or the date the related performance obligation is satisfied.

MONITOR DEVELOPMENTS

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The topic of non-cash consideration was discussed by the TRG at its January 2015 meeting. Specific questions brought to the attention of the TRG were:

- What is the measurement date for non-cash consideration received (or receivable) from a customer?
- How is the constraint applied to transactions in which the fair value of non-cash consideration might vary because of both the form of the consideration and for reasons other than the form of the consideration?

Stakeholders should monitor developments on this issue.

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Step 4—Allocate the Transaction Price to the Performance Obligations in the Contract

10. Allocating the Transaction Price

How is the transaction price allocated to the performance obligations in the contract?

Generally speaking, with the exception of allocating variable consideration and discounts, the transaction price (at inception) should be allocated to all the performance obligations in the contract in proportion to the stand-alone selling prices of each performance obligation.

The objective when allocating the transaction price is to ensure the amount allocated to each performance obligation represents the amount of consideration to which an entity expects to be entitled in the exchange.

In order to do so, entities must determine the stand-alone selling prices of the goods or services underlying the performance obligations.

If the stand-alone selling price is not directly observable, it should be estimated by considering all information reasonably available, such as market conditions, specific factors, class of customers, etc. Suitable methods for estimating the stand-alone selling price include (but are not limited to) the adjusted market assessment approach, the expected cost-plus-a-margin approach and, in limited circumstances, the residual approach.

Regardless of the method used, it should maximize the use of observable inputs and should be applied consistently when estimating the stand-alone selling price of goods or services with similar characteristics.

An entity should allocate a discount or variable consideration to all promised goods or services in the contract unless the entity has observable evidence the discount or the variable consideration relates to one or more, but not all, performance obligations in the contract. The standard provides specific guidance in such cases.

EXAMPLE: ALLOCATING THE TRANSACTION PRICE

A retailer sells a customer a computer-and-printer package for \$900. The retailer has determined that these are two separate performance obligations and regularly sells the printer for \$300 and the computer for \$700.

In this case, the entity will allocate the \$900 total transaction price as follows:

- Printer: $\$270 = \$900 \times (\$300 / (\$300 + \$700))$
- Computer: $\$630 = \$900 \times (\$700 / (\$300 + \$700))$

In this transaction, there is an inherent discount of \$100 which does not relate to a specific performance obligation and is therefore allocated to all performance obligations on a relative stand-alone selling price basis.

Step 5—Recognize Revenue When (or As) the Entity Satisfies a Performance Obligation

11. Transfer of Control

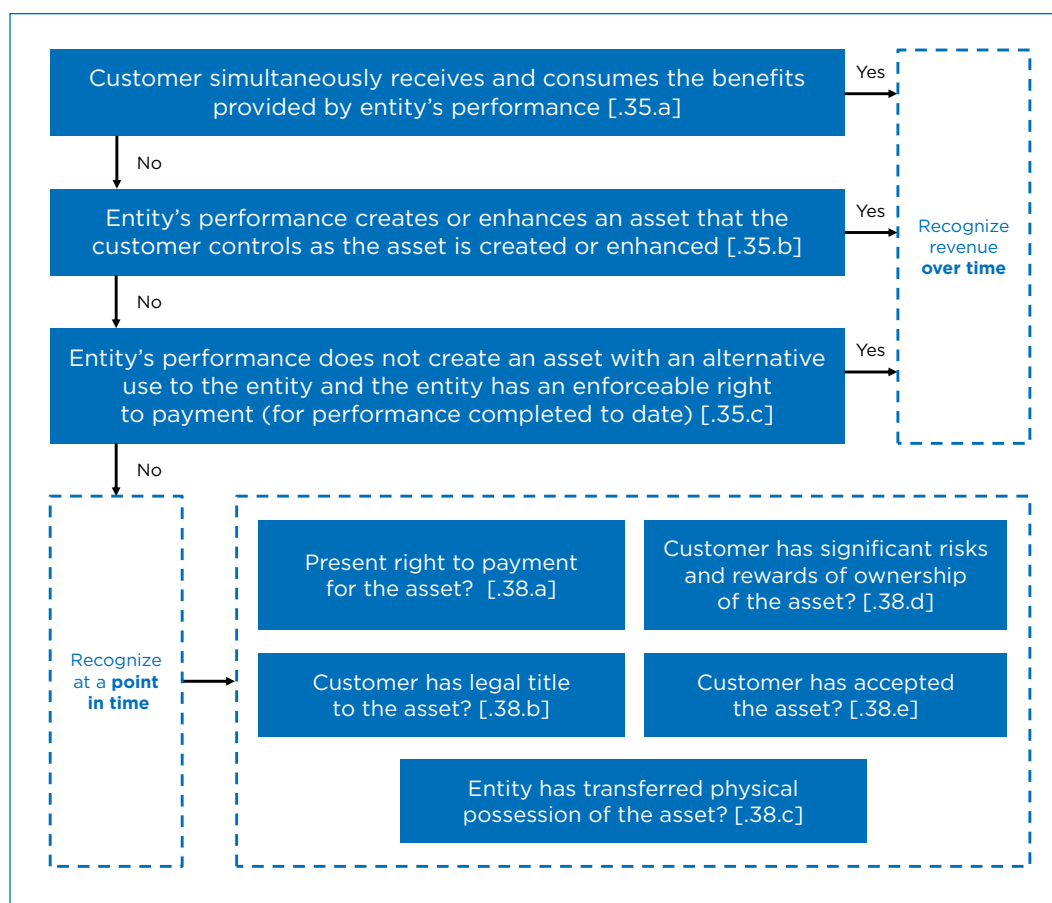
IFRS 15 is based on the transfer of control as opposed to the transfer of risks and rewards. Does this mean the transfer of risks and rewards is no longer relevant?

The Boards determined that an assessment based on the transfer of control as opposed to the transfer of the risks and rewards of ownership was more appropriate for a number of reasons. One such reason was that an assessment based on the transfer of control would result in more consistent decisions about when goods or services are transferred. In practice, there is often difficulty in assessing whether an appropriate level of the risks and rewards of ownership has been transferred to the customer, especially in cases when the selling entity retains some of the risks and rewards (e.g., risks retained during transport under a Free-on-Board (FOB) shipping point arrangement).

As such, the notion of “control” was incorporated into IFRS 15. This notion was established based on the definitions of an asset in the respective conceptual frameworks (i.e., IFRS and U.S. GAAP). As such, in the context of IFRS 15, goods and services are assets (even if momentarily) when they are received and used. A service can still be considered to be an asset, albeit momentarily, because in such a transaction the customer simultaneously receives and consumes the benefit. For example, consider an entity that promises to process transactions on behalf of a customer. The customer simultaneously receives and consumes the benefit associated with transaction processing as each transaction is processed. In such cases, the customer obtains control of the entity’s output as the entity performs and, given that the element of control exists, an asset exists.

IFRS 15 notes that control is the ability to direct the use of, and obtain substantially all of, the remaining benefits associated with the asset. However, control can also be an ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

In assessing the transfer of control, entities will need to begin by assessing whether control transfers over time. Control transfers over time if one of the criteria noted in the decision tree below is met. If none of these criteria is met, then the transfer of control occurs at a point in time but further analysis is required to determine the point in time the transfer occurs and revenue can be recognized.



As noted in the decision tree, the concept of "risks and rewards of ownership" has not completely disappeared from IFRS 15. In order to determine the point in time at which control transfers (i.e., and the point at which revenue recognition will occur), entities shall consider the transfer of the significant risks and rewards of ownership as one of the indicators in this assessment.

Depending on specific facts and circumstances, the timing of revenue recognition could change for certain entities because the transfer of the risks and rewards of ownership is no longer the only factor to be considered, but is now only one of the factors to be considered in determining when revenue can be recognized.

12. Shipping Terms

How will revenue recognition be impacted by shipping terms when the contract involves the sale of a good? For example, if the terms are “FOB Shipping Point”, what is the appropriate treatment and how will revenue recognition vary?

Although an assessment should be completed based on individual facts and circumstances, for the purposes of this question, assume it has been determined that the transfer of control and satisfaction of the performance obligation for this particular good is at a point in time. As such, a further assessment is required to determine the point at which control is transferred to the customer (i.e., the performance obligation is satisfied) and revenue should be recognized.

EXAMPLE: SHIPPING TERMS



An entity ships a good FOB shipping point. However, the entity has, as a matter of customary business practice, compensated customers for any loss or damage during shipment (through replacement of the lost or damaged good), often referred to as “synthetic FOB destination” shipping terms. Under IAS 18, it is likely that revenue would not have been recognized until the point of delivery (even though terms were FOB shipping point) since the entity has assumed the exposure to risk of loss during the shipping process.

However, under IFRS 15, the entity will need to further examine this assessment to determine whether the buyer has obtained control. Specifically, the entity will have to evaluate whether the buyer has obtained the “significant” risks and rewards of ownership of the shipped goods even though the seller maintains the risk of loss or damage to the goods during shipping. The determination of whether the significant risks and rewards have been transferred constitutes only one indicator (not in itself determinative) of whether the buyer has obtained control of the shipped goods and should be considered along with the other indicators in IFRS 15. Recognition of revenue upon shipment (subject to the other requirements of IFRS 15) would be appropriate if the seller concludes the buyer has obtained “control” of the goods upon shipment (on the basis of an overall evaluation of the indicators in IFRS 15.38 and other guidance in the Standard, despite the risk of loss or damage during shipment).

If control is determined to be transferred upon shipment, the seller is also required to consider whether the risk of loss or damage it assumed during shipping gives rise to another separate performance obligation (as a result of customary business practice) for “shipping risk coverage” service, and potentially allocate a portion of the total transaction price to this particular performance obligation.

A careful analysis should be completed to determine the point at which control is transferred and whether additional performance obligations exist.

13. Measuring Progress

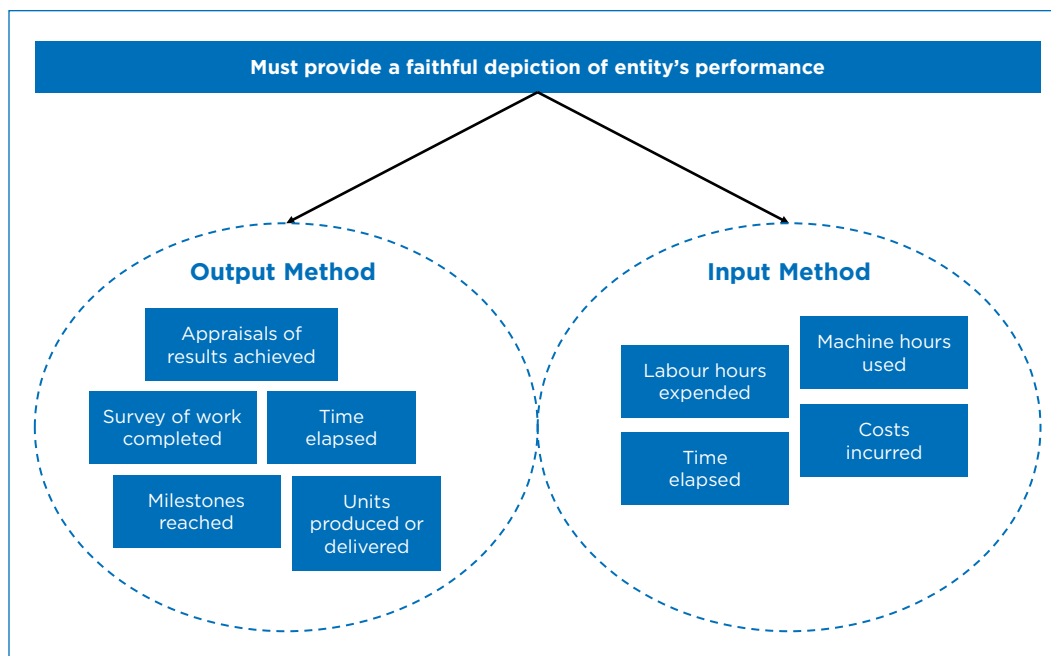
Is the percentage of completion method still appropriate under IFRS 15?

“Percentage of completion” is a term and method referred to under IAS 11 and IAS 18. It is important to note that the guidance in IAS 11 and 18 will be superseded by IFRS 15. However, IFRS 15 contains guidance consistent with the underlying concept and methods supporting the percentage of completion method, as referred to in existing IFRSs.

Under IFRS 15, performance obligations are first assessed against three specific criteria to determine whether recognition of revenue over time is appropriate (as discussed in question 11). If any one of these criteria is met, then a measure of progress toward satisfaction of the performance obligation must be determined. In determining this measure, IFRS 15 requires determination of a single method of measuring progress for each performance obligation and consistent application for similar performance obligations in similar circumstances. IFRS 15 provides some suggested methods (as noted below) based on either an output or input method. When selecting an appropriate method, it is necessary to ensure it faithfully depicts the entity’s performance.

As noted below, the various input and output methods are consistent with those methods referred to under the percentage of completion method in IAS 11 and IAS 18. Based on how IFRS 15 applies, in this context, some companies may have to re-evaluate the method they use to measure progress. For instance, the Basis for Conclusions indicates that certain methods, such as the units-of-delivery or units-of-production methods may not always result in the best depiction of an entity’s performance if the performance obligation is satisfied over time. This is because a units-of-delivery or a units-of-production method ignores the work in progress that belongs to the customer. When that work in progress is material to either the contract or the financial statements as a whole, using a units-of-delivery or a units-of-production method would distort an entity’s performance because it would not recognize revenue for the assets that are created before delivery or before production is complete but are controlled by the customer.

The methods noted below are not the only methods that can be used, but are merely suggested.



14. Performance Obligations Satisfied Over Time

When determining whether revenue should be recognized over time, one of the criteria is whether the entity's performance does not create an asset with an alternative use to the entity and whether there is an enforceable right to payment. What exactly does this mean?

It is important to keep in mind that for this particular "over-time" criterion, both aspects must be met (i.e., there must not be an alternative use for the asset *and* there must be an enforceable right to payment for performance completed to date).

In assessing whether an asset has an alternative use, entities need to consider both the practical limitations and contractual restrictions on redirecting the asset for another use. Consider, for example, manufacturing contracts where a basic product is being completed in a standard non-customized manner. If the manufacturer is building inventory that is interchangeable among customers, the inventory effectively has an alternative use to the manufacturer and the customer has no ability to restrict the manufacturer from redirecting the product. If the product were customized, another customer would arguably not want such a product because it would have no use to them and therefore no alternative use to the manufacturer.

However, simply using this basis (i.e., a standardized vs. customized product) as the basis for determining whether there is an "alternative use" for the product is not appropriate. There may also be cases whereby a standardized product is created, but the entity may not have an alternative use for the product.

This is often the case when there is a substantive contractual restriction on the product. Consider, for example, real estate contracts whereby contractual restrictions may restrict redirecting the asset to another customer. Again, facts and circumstances must be carefully analyzed since contractual restrictions do not automatically prevent “alternative use” to an entity (e.g., if, for example, they represent a protective right or if the contractual restriction is non-substantive). This assessment must be completed at contract inception. There may also be practical limitations (i.e., the entity may not be able to redirect the asset for another use without incurring significant costs to rework the asset). If this is the case, then the entity is incurring a significant economic loss, which would result in a practical limitation in redirecting the asset.

For an enforceable right to payment to exist, the entity must be entitled at all times during the contract to compensation for performance completed to date. Such compensation should *approximate* the selling prices for the goods or services transferred to date. For example, if recovery of costs is used as a basis, it should also include a reasonable margin. This margin is not required to be the same margin that would have been earned had the contract been completed, but rather may be:

- a proportion of the expected profit margin that reflects performance completed to date
- in cases where the contract-specific margin is higher than the return typically expected from similar contracts, the entity’s typical operating margin for similar contracts should be used.

Additional judgment will be required to determine what is a “reasonable” margin and what constitutes enforceability.¹⁵

Contract Costs

15. Contract Costs

IFRS 15 has a broadened scope since it not only addresses revenue recognition, but also addresses the requirements for contract costs. What exactly are “contract costs” and how are these addressed in IFRS 15?

IFRS 15 notes that there are two types of contract costs. Although both types of costs must usually be capitalized (if certain criteria are met), amortized and tested for impairment, there are some differences between the two types of costs and whether they are required to be capitalized, which should be carefully considered.

¹⁵ IFRS 15 provides some guidance on this in Appendix B.

Incremental Costs of Obtaining a Contract

Entities sometimes incur costs to obtain a contract, such as selling and marketing costs, bid and proposal costs, sales commissions, and legal fees.

Costs to be capitalized are those costs that entities would not have incurred had the contract not been obtained. In addition, for such costs to be recognized as an asset, the entity must expect to recover these costs.

PRACTICAL EXPEDIENT(S)!



If the expected period of amortization (discussed below) for the incremental costs of obtaining a contract is one year or less, capitalization is not required.

In determining the expected period of amortization, contract renewals should be considered.

Entities must apply the use of practical expedients consistently to contracts with similar characteristics and in similar circumstances.

Costs to Fulfill a Contract

Entities often incur costs to fulfill their obligations under a contract. Accounting for such costs can be explained as a two-step process:

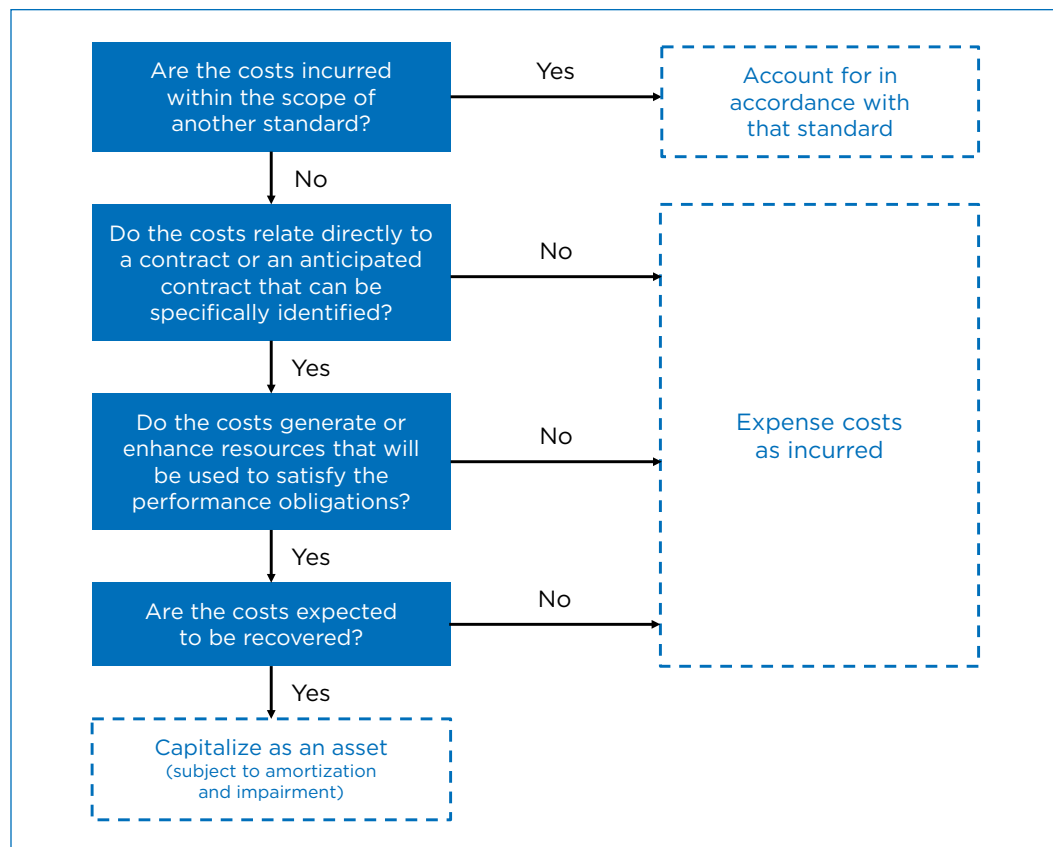
- a. Determine whether the accounting for such costs is addressed by other standards (e.g., IAS 2 *Inventories*) and, if so, apply that guidance.
- b. Fulfillment costs not addressed by other standards should be capitalized if all the following criteria are met:
 - costs relate directly to a contract or to an anticipated contract the entity can specifically identify (e.g., costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract not yet approved) [IFRS 15.95(a)]
 - costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future [IFRS 15.95(b)]
 - costs are expected to be recovered [IFRS 15.95(c)].

NOTE: There is no practical expedient available for costs to fulfill a contract.

Once capitalized, these assets should be amortized on a systematic basis (i.e., this basis should reflect the pattern of transfer of the goods or services under the contract to which the asset relates).

The assets recognized as related to the incremental costs of obtaining a contract and the costs to fulfill a contract should be impaired, in cases where the carrying amount of the asset exceeds the remaining consideration expected (in exchange for the goods and services) less the costs that relate directly to providing those goods or services and that have not been recognized as expenses.

Costs to Fulfill a Contract



EXAMPLE: ACCOUNTING FOR CONTRACT COSTS



A media company owns and operates radio stations. The main revenue stream is advertising revenue. Contracts are signed with various businesses for the sale of airtime.

The account executives obtain these contracts and are compensated through a 5% commission on the total contract price for each new contract signed.

Executive X has obtained a new two-year advertising contract with Company ABC. Total contract costs related to this contract are as follows:

Cost	Amount
Legal fees contract drafting (incurred on a “no win, no fee” basis)	\$10,000
Commission paid to the account executive	\$7,500
Meals and entertainment incurred during the sales process	\$1,750
Creative Director’s time salary allocation of Creative Director to develop on-air ad	\$1,500
Actors amounts paid to external actors to record the on-air ad	\$750
Total Costs	\$21,500

The legal fees and commission will be considered an “incremental cost of obtaining a contract” because these costs were only incurred as a result of obtaining the contract. The company expects to recover these costs through the future advertising revenue that will be earned under the contract. Had the contract not been obtained, these costs would not have been incurred. If the legal fees had been incurred prior to obtaining the contract, they would not be capitalized.

The meals and entertainment costs are not eligible to be capitalized because they would have been incurred regardless of whether the contract had been obtained.

The costs related to the Creative Director’s time and the costs associated with hiring actors are direct labour costs associated with providing the advertising services and are considered to be costs directly related to the contract and are not covered by any other standard. These costs also meet the required criteria for capitalization, because they:

- are specifically identified through time-sheet allocations and invoices (i.e., relate directly to the contract)
- provide a resource (e.g., Creative Director and Actor) used to satisfy the performance obligation
- will be recovered through contract revenue earned.

Once these costs are capitalized, they will be amortized and assessed for impairment in accordance with IFRS 15.

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)



The topic of impairment testing related to contract costs was discussed by the TRG at its July 2014 meeting. The specific question brought to the attention of the TRG was whether the consideration expected to be received during renewal or extension periods should be considered in the impairment analysis.

TRG members stated that IFRS 15 requires an entity to consider contract renewals and extensions in “the remaining amount of consideration the entity expects to receive”. TRG members noted that this view was supported by the discussion in the Basis for Conclusions on IFRS 15 (paragraphs BC309 and BC310) and the totality of the guidance in IFRS 15 (paragraphs 99-104) which states that the “goods or services to which the asset relates” include goods or services from specifically anticipated future contracts such as renewals or extensions.

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Specific Application Considerations

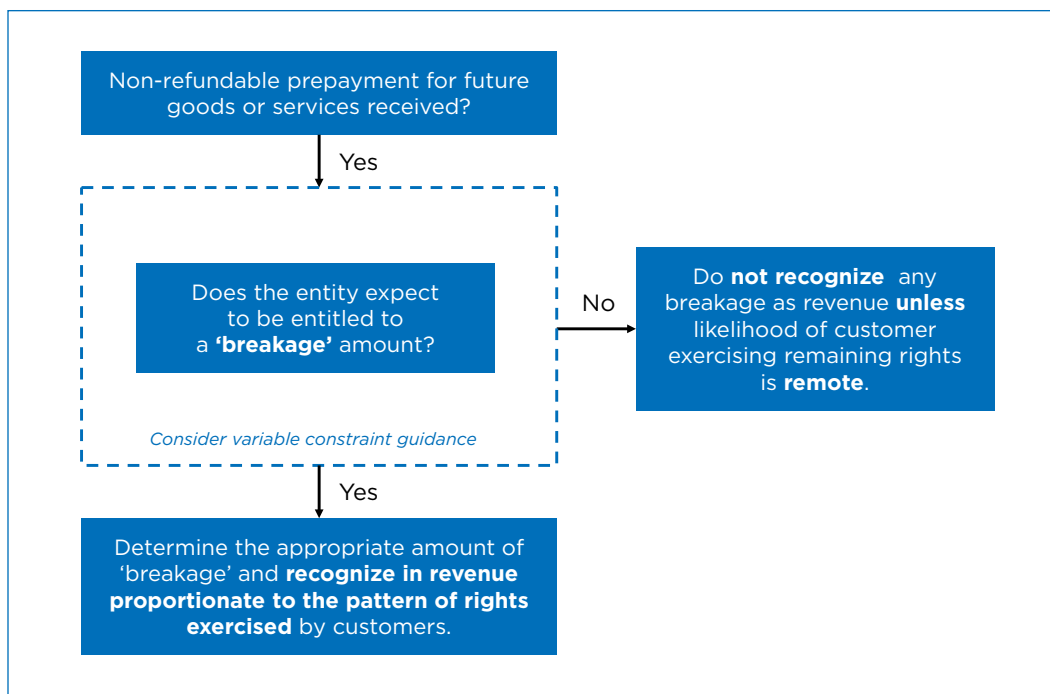
16. Gift Cards

How are gift cards accounted for under IFRS 15?

As gift cards are sold, a contract liability is recognized and as customers redeem the cards for goods or services, revenue is recognized because the related performance obligation has been satisfied.

Customers may not always exercise their contractual rights to redeem the gift cards in full. IFRS 15 refers to this unredeemed amount (i.e., the unexercised rights) as “breakage”. If an entity expects to be entitled to such breakage amounts (i.e., customers are not expected to exercise their rights in full), the entity recognizes breakage in revenue based on the pattern of recognition of the goods and services transferred to the customers. To determine entitlement to such breakage amounts, entities should apply the guidance related to constraining variable consideration (discussed in question 6). Specifically, breakage can only be recognized if it is highly probable that recognizing breakage will not result in a significant reversal of the cumulative amount of revenue recognized.

If an entity does not have sufficient information to predict whether it will be entitled to such breakage amounts, breakage will only be recognized as revenue when the likelihood of customers exercising the outstanding rights is *remote*.



EXAMPLE: ACCOUNTING FOR GIFT CARDS



An entity sells a \$100 gift card to a customer, with no expiry date. The entity maintains statistics on its gift card sales and redemptions and has noted that historically only 80% of gift cards are redeemed and 20% are unexercised.

The entity believes this historical information has appropriate predictive value and estimates that 20% of the value of the gift cards will not be redeemed. In addition, the entity applies the guidance on constraining variable consideration and determines it is highly probable a significant revenue reversal will not occur once these breakage amounts are recorded in revenue (i.e., using an appropriate pattern of recognition). Therefore, it is appropriate to recognize these amounts as breakage in revenue.

Initially, the entity will record a contract liability for the \$100 gift card. The entity will also have to account for the 20% breakage. However, since this amount cannot be recognized upfront, it will initially remain as part of the \$100 liability.

As the customer exercises its rights by redeeming the card, a proportionate amount of breakage can be recognized. In year one, the customer makes one purchase of \$50 using the gift card. Therefore, when this purchase is made, rather than recognizing \$50 of revenue, \$62.50 of revenue will be recognized to incorporate expected breakage (i.e., $\$50 \times (100/80)$).

17. Warranties

How are warranties accounted for under IFRS 15?

The guidance in IFRS 15 on warranties has been developed acknowledging the different types of warranties. Under IFRS 15, warranties are grouped in two types: assurance and service. What distinguishes them is whether the warranty simply provides assurance the product complies with agreed-upon specifications or whether it provides a service in addition to the assurance.

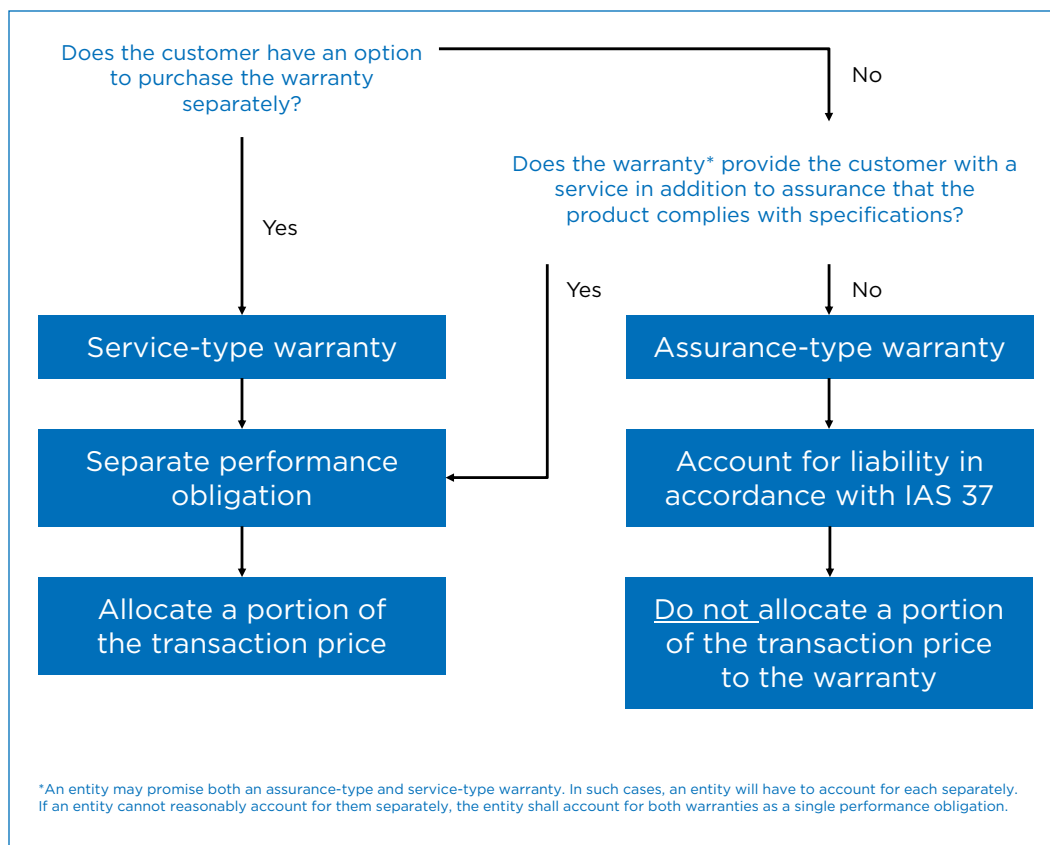
If the customer has the option to purchase the warranty, the warranty is a “service-type” warranty and will need to be accounted for as a separate performance obligation.

If the customer does *not* have the option to purchase the warranty separately, then the warranty may not provide a distinct service and may simply provide assurance regarding the existing product. An assessment is therefore required to determine whether the customer is still receiving a service. Examples of factors to be considered in completing this assessment include:

- whether the warranty is required by law
- the length of the warranty coverage period
- the nature of the tasks the entity promises to perform.

If it is determined that no distinct service is provided, such warranties are referred to as “assurance-type” warranties. Such warranties will be accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Refer to the steps in the following decision tree when determining the nature of and accounting for warranties:



EXAMPLE: ACCOUNTING FOR A WARRANTY



A customer enters into a contract with a heavy duty machine manufacturer for the purchase of a tractor for \$100,000. All pieces of equipment sold by the manufacturer come with a one-year standard warranty that specifies the equipment will comply with the agreed-upon specifications and will operate as promised for a one-year period from the date of purchase.

In signing this contract, the customer also requested to purchase an additional \$2,000 two-year warranty commencing after the expiry of the standard one-year warranty.

There are two warranties in this contract:

1. assurance-type warranty—for first year after purchase
2. service-type warranty—for two years after expiry of the initial standard warranty.

Given that the customer has the option of purchasing the additional warranty separately, this is a service-type warranty and is accounted for as a separate performance obligation. Deferred revenue of \$2,000 is recognized (as opposed to revenue being recorded) until the performance obligation is satisfied.

The assurance-type warranty is accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

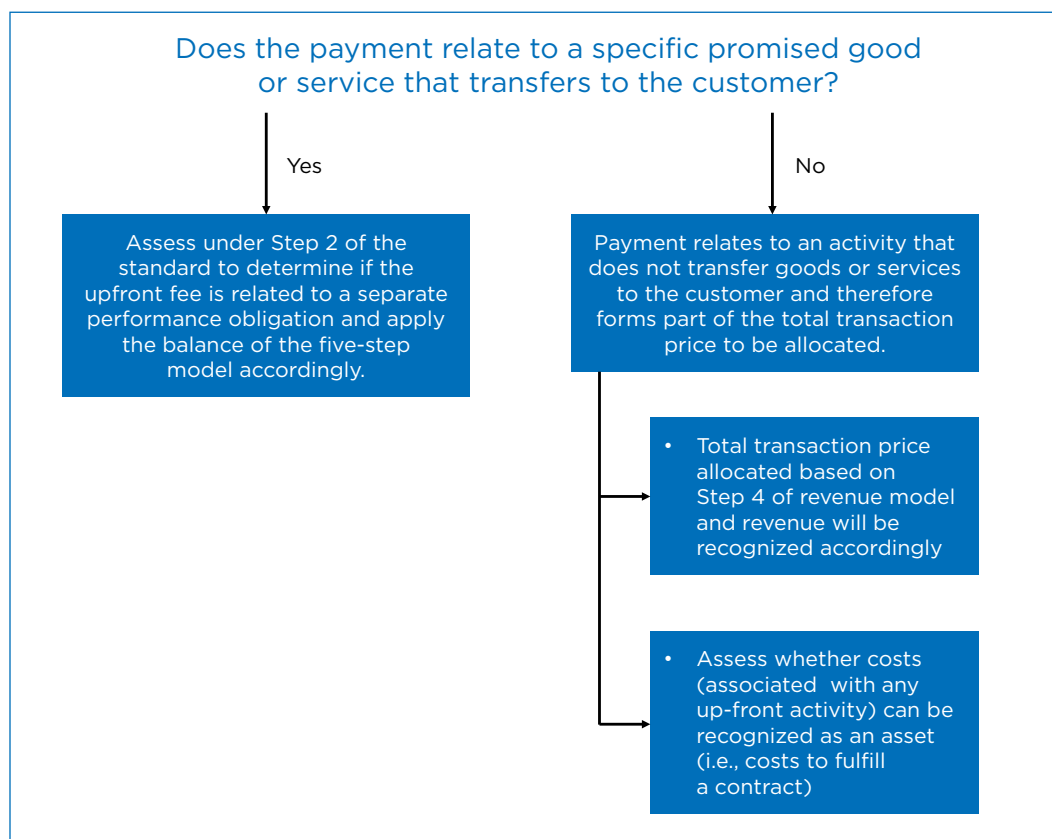
18. Non-Refundable Upfront Fees

How are non-refundable upfront fees (e.g., non-refundable initiation or membership fees) accounted for?

An entity will need to assess if non-refundable fees relate to a separate performance obligation.

When the upfront fee represents an advance payment for future goods or services, such fees would be recognized as revenue only when those future goods or services are provided.

Refer to the decision tree below to determine the appropriate accounting treatment for such fees.

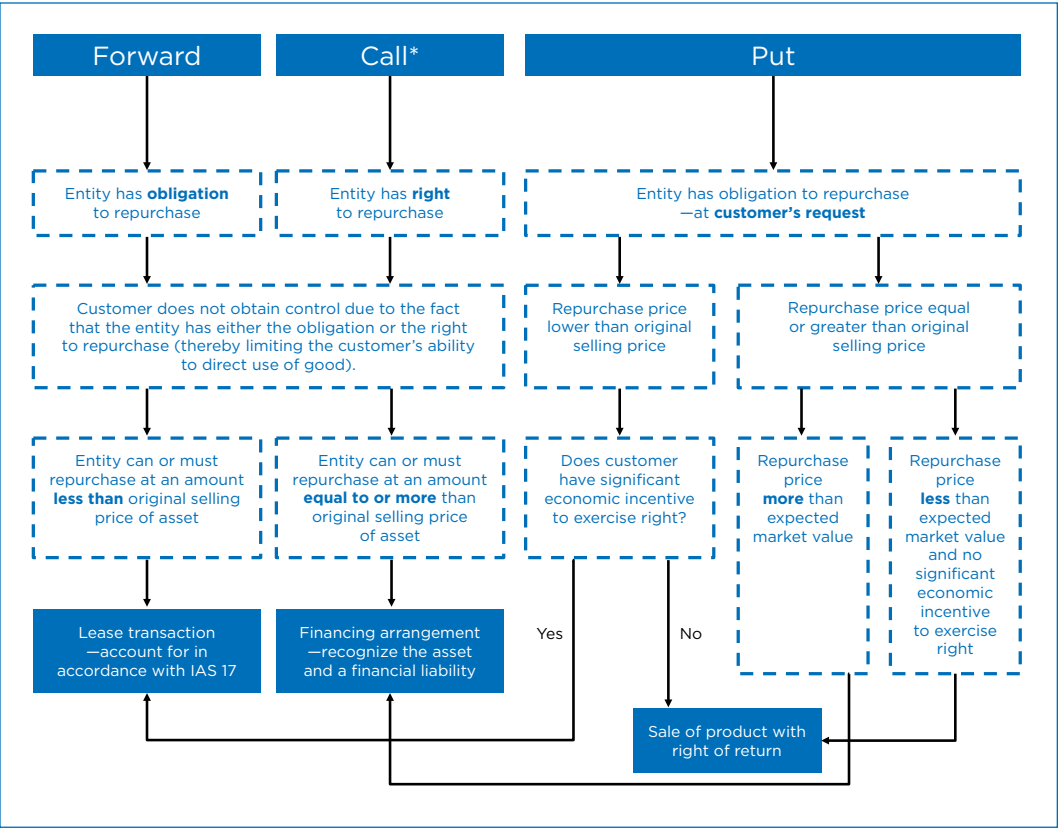


19. Repurchase Agreements

What exactly are “repurchase agreements” and what is their impact on accounting for revenue under IFRS 15?

Repurchase agreements are agreements in which an entity will sell a good to a customer but either 1) promises or 2) has the option of repurchasing the particular good. The asset repurchased does not necessarily need to be the asset originally sold to the customer; it may be substantially the same, or even a component of the original.

Repurchase agreements generally take one of three forms: 1) a forward,¹⁶ 2) a call option¹⁷ or 3) a put option.¹⁸ The resulting accounting will depend on a number of considerations as has been illustrated in the decision tree below.



*Call option must be *substantive* to be in scope.

16 Whereby an entity has an obligation to repurchase
17 Whereby an entity has a right to repurchase
18 Whereby an entity has an obligation to repurchase at the customer's request

EXAMPLE: REPURCHASE AGREEMENT



An auto manufacturer (i.e., an original equipment manufacturer (OEM)) contracts with a lease-broker to sell 40 units of a particular model of vehicle A at a price of \$20,000 per unit. At the lease-broker's request, the OEM agrees to repurchase any units six months after the date of the original sale. The agreement stipulates the vehicles will be repurchased at a value of \$19,000 per unit. At the time of repurchase, the market value is expected to be \$16,000 per unit.

Under existing IFRSs guidance, although the principle exists, there is no detailed guidance on how to account for such transactions. However, under IFRS 15 (by applying the above decision tree), this particular repurchase agreement is a put option since the lease-broker has the right to require the OEM to repurchase the units.

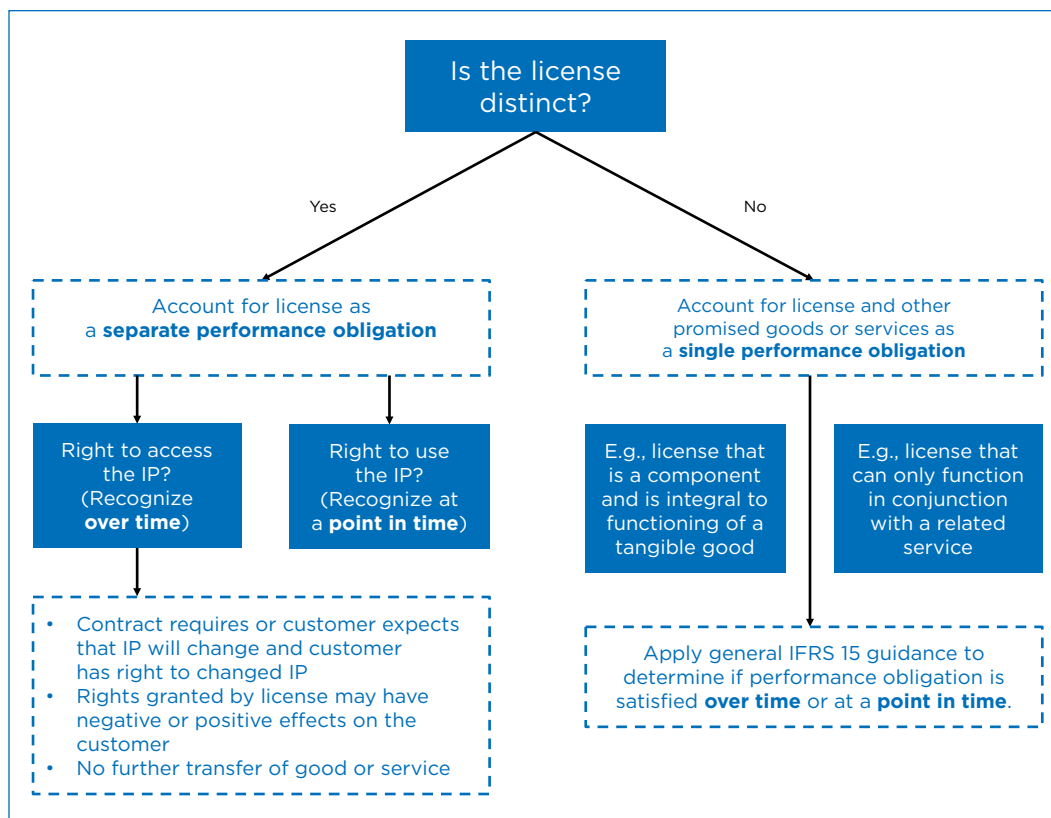
At a repurchase price of \$19,000 per unit, the price is lower than the original selling price of \$20,000 and therefore an assessment is required as to whether the customer has a significant economic incentive to exercise this right. In this particular example, at the end of the six-month period, the market value of such vehicles is expected to be \$16,000.

An argument may be made that the customer has significant economic incentive to exercise this right, since the amount received from the OEM exceeds the expected market value. In this case, this transaction is not a "sale" that generates revenue within the scope of IFRS 15, but rather a lease transaction accounted for in accordance with IAS 17.

20. Licences

There seems to be very specific guidance in IFRS 15 related to licences and the initial starting point is to determine whether a licence is distinct. How is this assessment made?

This is correct. IFRS 15 does introduce very specific guidance on accounting for licences. There is no comparable detailed guidance on accounting for licences under existing IFRSs. Licences are used to transfer the right to use the intellectual property (IP) of an entity and to establish the obligations of the entity to provide those rights. Given that licences are used in many industries (e.g., software and technology, media, franchising, etc.), the impact of the new guidance can be widespread. The following decision tree can be used to determine the appropriate accounting for licences.



As noted in the decision tree, if a licence is determined to be distinct, entities must next determine the nature of the licence in order to determine the revenue recognition pattern. If the licence is “a right to access”, revenue allocated to the licence is recognized over time. If the licence is a “right to use”, revenue allocated to the licence is recognized at a point in time.

EXAMPLE: LICENSE OF INTELLECTUAL PROPERTY



Source

Illustrative Example 55
IFRS 15 *Revenue from Contracts with Customers*



This example accompanies, but is not part of, IFRS 15. This example illustrates aspects of IFRS 15 but is not intended to provide interpretative guidance.

An entity enters into a contract with a customer to license (for a period of three years) intellectual property related to the design and production processes for a good. The contract also specifies that the customer will obtain any updates to that intellectual property for new designs or production processes that may be developed by the entity.

The updates are essential to the customer's ability to use the license, because the customer operates in an industry in which technologies change rapidly. The entity does not sell the updates separately and the customer does not have the option to purchase the license without the updates.

The entity assesses the goods and services promised to the customer to determine which goods and services are distinct in accordance with paragraph 27 of IFRS 15. The entity determines that although the entity can conclude that the customer can obtain benefit from the license on its own without the updates (see paragraph 27(a) of IFRS 15), that benefit would be limited because the updates are critical to the customer's ability to continue to make use of the license in the rapidly changing technological environment in which the customer operates. In assessing whether the criterion in paragraph 27(b) of IFRS 15 is met, the entity observes that the customer does not have the option to purchase the license without the updates and the customer obtains limited benefit from the license without the updates. Therefore, the entity concludes that the license and the updates are highly interrelated and the promise to grant the license is not distinct within the context of the contract, because the license is not separately identifiable from the promise to provide the updates (in accordance with the criterion in paragraph 27(b) and the factors in paragraph 29 of IFRS 15).

The entity applies paragraphs 31–38 of IFRS 15 to determine whether the performance obligation (which includes the license and the updates) is satisfied at a point in time or over time. The entity concludes that because the customer simultaneously receives and consumes the benefits of the entity's performance as it occurs, the performance obligation is satisfied over time in accordance with paragraph 35(a) of IFRS 15.

MONITOR DEVELOPMENTS

IASB Discussions



The topic of licences was discussed by the IASB in its February 2015 Board meeting.¹⁹

The IASB decided to improve the operability and understandability of the Application Guidance in IFRS 15. To do so, the IASB propose clarifying that the entity's promise to the customer in granting a licence is to provide a right to access the entity's intellectual property (which is satisfied over time) when the contract requires or the customer reasonably expects the entity to undertake activities (that do not transfer a good or service to the customer) that significantly affect the utility of the intellectual property to which the customer has rights.

The utility of the intellectual property to which the customer has rights is significantly affected when either:

- The anticipated activities of the entity are expected to change the form (e.g., the design) or the functionality (e.g., the ability to perform a function or task) of the intellectual property to which the customer has rights.
- The value of the intellectual property to the customer is substantially derived from, or dependent upon, the expected activities of the entity. For example, the value of a brand or logo is typically derived from, and dependent upon, the entity's ongoing activities that support or maintain the intellectual property.

In addition, the IASB clarified that, when intellectual property has significant stand-alone functionality (i.e., the ability to process a transaction, perform a function or task, or be played or aired), such as software or media content, a substantial portion of its utility is derived from that functionality and is unaffected by activities of the entity that do not change that functionality (e.g., promotional activities).

The IASB decided that a clarification to the application guidance in IFRS 15 was not required to determine when an entity should assess the nature of a licence, in a situation where a licence is not a separate performance obligation. The IASB decided this was not necessary because there is adequate guidance in IFRS 15 and the accompanying Basis for Conclusions on IFRS 15.

The IASB decided to clarify the scope and applicability of the Application Guidance on sales-based or usage-based royalties promised in exchange for a licence of intellectual property as follows:

- An entity should not split a single royalty into a portion subject to the sales-based or usage-based royalties exception and a portion that is not subject to the royalties constraint (and, therefore, would be subject to the general guidance on variable consideration, including the constraint).
- The sales-based or usage-based royalties exception should apply whenever the predominant item to which the royalty relates is a licence of intellectual property.

The IASB decided that a clarification to the Application Guidance in IFRS 15 with respect to contractual restrictions in a licence agreement was not necessary because there is adequate guidance in IFRS 15 and the accompanying Basis for Conclusions on IFRS 15.²⁰

¹⁹ Note—This was a joint Board meeting with the FASB.

²⁰ Note—The decisions made by the IASB were not necessarily the same as those of the FASB.

21. Material Right

IFRS 15 includes specific requirements related to “customer options for additional goods or services” and requires a distinction to be made as to whether this option confers a “material right”. What is a “material right” and how do you make this assessment?

Contracts may provide customers with the option to acquire additional goods or services either for free or at a discount through loyalty point programs, customer award credits, sales incentives, contract renewal options, etc. Under existing IFRSs, the most comparable guidance is under IFRIC 13 *Customer Loyalty Programmes*; however, this guidance was specific to loyalty programs. This guidance will be superseded with the guidance in IFRS 15 related to “customer options for additional goods or services”.

If the option provides a right the customer would not have received had they not entered into this contract, (e.g., a right incremental to the rights provided to other customers in the same region or market), the customer is in effect paying in advance for future goods and services. If such an option provides the customer with a “material right”, then the option should be accounted for as a separate performance obligation.

However, if the option is simply providing the customer with the ability to acquire additional goods or services at a price reflective of the stand-alone selling price, then this option does not provide a “material right” even though such an option may only be obtained as a result of entering into a contract.

Once the determination has been made that a material right exists and it is a separate performance obligation, a portion of the total transaction price must be allocated to this right. If the stand-alone selling price of the material right is not directly observable, it must be estimated. In determining this value, entities should factor into their estimate:

- any discounts that could be obtained without exercising the option
- the likelihood the option will be exercised.

The concept and related guidance of a “material right” was aimed at distinguishing between additional options and marketing or promotional offers. In order to provide additional guidance in making this distinction, the Boards note that the notions of “significant” and “incremental” form the basis of what it means to have a “material right” and should be considered in order to differentiate between an option and a marketing offer.

EXAMPLE: MATERIAL RIGHT

An entity is a wholesale distributor of hair salon products that are generally accessible through a membership fee only. In an effort to expand the business and increase market share, the entity is no longer limiting accessibility to individuals with memberships and is allowing new customers to make purchases without requiring them to purchase membership cards. All new customers are provided a 10% discount voucher on any purchases made in the month of May.

However, in an effort to encourage existing members to continue to shop and increase their purchase volume, the entity is offering these members a 30% discount voucher on all their purchases made throughout the month of May, if they purchase product X in April.

In this case, the 30% discount provides these customers with an incremental discount of 20% compared to the 10% discount typically offered to other customers. This option (i.e., incremental discount) is not received unless the customer is both a member and makes purchases in the month of April. This option suggests a material right exists.

The distributor should also consider the stand-alone selling price. If the option is simply providing a right to purchase goods or services at their stand-alone selling prices, then this is not a material right. In this case, the customer is acquiring future goods and services at an amount below their stand-alone selling prices and therefore a material right does exist and should be accounted for as a separate performance obligation.

The 10% discount offered to all other customers is simply a “marketing incentive” and is accounted for as such.

Loyalty Programs

A loyalty program that provides the customer with a material right (as discussed above) creates a performance obligation for which a portion of consideration in the contract must be allocated.

EXAMPLE: CUSTOMER LOYALTY PROGRAMME**Source**

Illustrative Example 52
IFRS 15 *Revenue from Contracts with Customers*



This example accompanies, but is not part of, IFRS 15. This example illustrates aspects of IFRS 15 but is not intended to provide interpretative guidance.

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and the stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (totaling CU9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of IFRS 15.

EXAMPLE: CUSTOMER LOYALTY PROGRAMME



The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (CU100,000) to the product and the points on a relative stand-alone selling price basis as follows:

Product = 91,324 [CU100,000 × (CU100,000 stand-alone selling price ÷ CU109,500)]

Points = 8,676 [CU100,000 × (CU9,500 stand-alone selling price ÷ CU109,500)]

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognizes revenue for the loyalty points of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676] and recognizes a contract liability of CU4,566 (CU8,676 – CU4,110) for the unredeemed points at the end of the first reporting period.

At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognizes revenue for the loyalty points of CU3,493 [(8,500 total points redeemed ÷ 9,700 total points expected to be redeemed) × CU8,676 initial allocation] – CU4,110 recognized in the first reporting period}. The contract liability balance is CU1,073 (CU8,676 initial allocation – CU7,603 of cumulative revenue recognized).

Renewal Options

Renewal options generally provide a customer with a right to continue acquiring additional goods or services under terms specified in the existing contract. Renewal options can be considered options to purchase additional goods or services if they provide a “material right”. Therefore further assessments will have to be completed based on existing facts and circumstances.

EXAMPLE: RENEWAL OPTIONS



Consider the following examples:

Option	Material Right
An entity enters into a contract with a customer to provide the new iPhone and service coverage which includes (among other terms) 2,000 Canada-wide minutes a month for a price of \$70/month. If the customer goes over their minutes, they will be charged for additional minutes at the stand-alone selling price of \$0.35/minute.	No. The price for additional minutes reflects the stand-alone selling price.
An entity enters into a contract with its customer whereby the customer must pay a significant non-refundable upfront fee (that does not relate to a specific promised good or service) but entitles the customer to renew the contract annually without having to pay an additional fee.	Yes. The customer is able to renew their membership at no cost (the value of which is material to the contract).

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)



The topic of “customer options for additional goods and services” was discussed by the TRG at its October 2014 meeting. Specific questions brought to the attention of the TRG were:

- Should the evaluation to determine whether an option provides a material right be performed in the context of only the current transaction with a customer or should the evaluation also consider past and expected future transactions with the customer?
- Is the evaluation of whether an option provides a material right solely a quantitative evaluation or should the evaluation also consider qualitative factors?

The view of most TRG members was that past and expected future transactions with the customer, as well as facts and circumstances that exist outside of the current transaction with the customer, should be considered when evaluating whether a customer option gives rise to a material right, including how a right accumulates over time.

The view of most TRG members on the second question was that the assessment of whether an option gives rise to a material right includes both quantitative and qualitative factors.

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22. Bill-and-Hold

The Illustrative Examples accompanying IAS 18 Revenue had guidance in regard to “bill-and-hold” sales and provided specific criteria that had to be met in order for revenue to be recognized in such transactions. Is there similar guidance under IFRS 15? Has this changed?

Yes. Under IFRS 15, similar guidance exists; however, the required criteria are somewhat different. Although the underlying principle in assessing these transactions remains similar, there are slight differences in the criteria and therefore careful consideration will still be required.

Bill-and-hold arrangements are those whereby an entity bills a customer for the sale of a particular product, but the entity retains physical possession until it is transferred to the customer at a later date.

In assessing whether revenue can be recognized in a bill-and-hold transaction, entities must first determine whether control has transferred to the customer (as with any other sale under IFRS 15) through review of the indicators for the transfer of control. One indicator is physical possession of the asset; however, physical possession may not coincide with control in all cases (e.g., in bill-and-hold arrangements). In determining whether control has transferred in such arrangements, the specific criteria included in IFRS 15 for bill-and-hold transactions must *all* be met in order for revenue to be recognized.

The specific *additional criteria* for revenue recognition under bill-and-hold arrangements are listed below. These have also been compared to the criterion under IAS 18 to illustrate the differences.

IAS 18	IFRS 15
<ul style="list-style-type: none"> The buyer specifically acknowledges the deferred delivery instructions. 	<ul style="list-style-type: none"> The reason for the bill-and-hold arrangement must be substantive (e.g., the customer has requested the arrangement).
<ul style="list-style-type: none"> The item is on hand, identified and ready for delivery to the buyer at the time the sale is recognized. 	<ul style="list-style-type: none"> The product must be identified separately as belonging to the customer. The product currently must be ready for physical transfer to the customer.
<ul style="list-style-type: none"> It is probable that delivery will be made. 	
	<ul style="list-style-type: none"> The entity cannot have the ability to use the product or to direct it to another customer.
<ul style="list-style-type: none"> The usual payment terms apply. 	

An entity that has transferred control of the goods and met the bill-and-hold criteria to recognize revenue will also need to consider whether it is providing other services (e.g., custodial services). If so, a portion of the transaction price should be allocated to each of the separate performance obligations (i.e., the goods and the custodial service).

23. Principal vs. Agent

What is the guidance on accounting for transactions as a principal vs. an agent under IFRS 15?

IFRS 15 includes guidance regarding principal vs. agent considerations. Specific indicators are provided to assist in determining whether an entity is acting as an agent.

The presumption is that if an entity controls the good or service before transfer to the customer, the entity is the principal. This is not a definitive conclusion as may be the case when an entity obtains legal title of a product momentarily.

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

- another party is primarily responsible for fulfilling the contract [IFRS 15.B37(a)]
- the entity does not have inventory risk before or after the goods have been ordered by a customer, during shipping or on return [IFRS 15.B37(b)]
- the entity does not have discretion in establishing prices for the other party's goods or services and, therefore, the benefit the entity can receive from those goods or services is limited [IFRS 15.B37(c)]

- the entity's consideration is in the form of a commission [IFRS 15.B37(d)]
- the entity is not exposed to credit risk for the amount receivable from a customer in exchange for the other party's goods or services [IFRS 15.B37(e)].

Identifying the nature of the entity's promise is a fundamental part of the process of determining whether an entity is acting as a principal or agent. Because the nature of an entity's promise is not always apparent, the indicators listed in IFRS 15 (discussed above) have been included to assist in making this determination.

MONITOR DEVELOPMENTS

IASB | FASB Joint Transition Resource Group for Revenue Recognition (TRG)



The topic of gross vs. net presentation (i.e., acting as a principal or an agent) was discussed by the TRG at its July 2014 meeting. Specific questions brought to the attention of the TRG were:

- How should the principal-agent indicators in IFRS 15 interact with the presumption that a principal controls the good or service before its transfer to the customer?
- How should those indicators be applied to certain types of contracts (specifically, those for intangible goods or services and those for which the indicators provide contradictory evidence)?
- If an entity determines it is the principal and that the intermediary to which it provides the goods or services is an agent, what amount of revenue should the entity recognize if it receives a net amount of cash from the intermediary (i.e., amount from the end customer less commission retained) but does not know the amount paid by the end customer?
- How should the transaction price allocation guidance be applied to a transaction in which the entity is a principal for some of the goods or services and an agent for others?

TRG members observed that the principal vs. agent analysis requires the use of significant judgment under current IFRSs and significant judgment will likely be necessary to apply the new revenue standard.

The TRG members also observed that the principal-agent indicators in IFRS 15 are similar to those in the current revenue guidance.

The discussion ultimately helped to inform the IASB about the challenges expected to arise applying this guidance. The IASB instructed the staff to perform additional research on the topic.

To download audio recordings or meeting reports of agenda topics visit www.ifrs.org or click [here](#).

24. Contract Modifications

How are contract modifications accounted for? For example, in the case of construction contracts, or other long-term service contracts, modifications are frequent. How should these be accounted for in the context of IFRS 15?

IFRS 15 provides specific guidance around contract modifications, which are considered to be “change[s] in the scope or price (or both) of a contract that are approved by the parties to the contract”.

Contract modifications may be accounted for in a number of different ways, depending on the nature of the change.

As a starting point in assessing contract modifications, an assessment is required to determine whether a modification is approved. Once approved, a determination must be made as to whether the contract modification should be accounted for as a separate contract. In order for the modification to be accounted for as a separate contract, the following two conditions must both exist (further illustrated in the decision tree below):

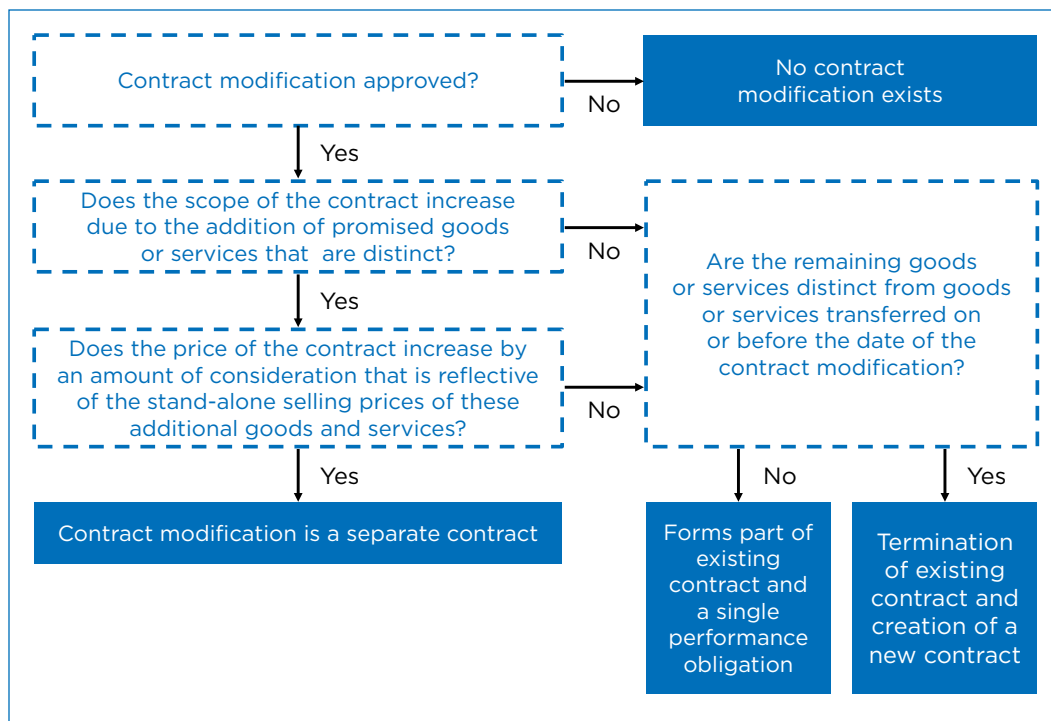
- a. The scope of the contract increases because of the addition of promised goods or services that are distinct [IFRS 15.20(a)].
- b. The price of the contract increases by an amount of consideration that reflects the entity’s stand-alone selling price of the additional goods or services [IFRS 15.20(b)].²¹

If both conditions are met, the modification is treated as a separate contract, and the five-step model will be applied separately to this contract. The accounting for the existing contract will remain unchanged and the five-step model will continue to apply to that contract as is. The accounting for such a modification is fully prospective.

If these conditions are not met, but the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification, then entities will be required to treat the modification as if it were the creation of a new contract (which will include both the remaining goods or services of the original contract and (if applicable) the goods and services promised in the modification). Effectively, the original contract is terminated. The accounting for such a modification is fully prospective. Although such modifications are accounted for prospectively and the original contract is considered to be terminated, the remaining consideration from the original contract that was not recognized as revenue and the consideration from the modification are combined and recognized as the remaining performance obligations are satisfied.

²¹ Subject to certain adjustments to reflect the circumstances of that particular contract.

However, if the remaining goods or services are not distinct from the goods or services transferred on or before the modification, the modification will be considered part of the remaining performance obligation(s) in the contract and an adjustment must be made to the cumulative amount of revenue to reflect the effect the modification has on the transaction price and the entity's measure of progress towards satisfaction of the performance obligation(s). The accounting impact for such a modification is retrospective.



EXAMPLE: MODIFICATION OF A CONTRACT FOR GOODS



Source

Illustrative Example 5
IFRS 15 *Revenue from Contracts with Customers*



This example accompanies, but is not part of, IFRS 15. This example illustrates aspects of IFRS 15 but is not intended to provide interpretative guidance.

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

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

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

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

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

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

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

Consequently, the amount recognized as revenue for each of the remaining products is a blended price of CU93.33 $\{[(CU100 \times 60 \text{ products not yet transferred under the original contract}) + (CU80 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$.

EXAMPLE: MODIFICATION OF A CONTRACT TO CONSTRUCT A BUILDING



Construction Co. completes commercial construction projects. These projects generally take a significant amount of time to complete, ranging from two—three years. During this time, the customer specifications for the contract may change.

Construction Co. has entered into a contract with a customer to build a new 10-storey office building, expected to take two and a half years to complete. This contract is for a fixed fee of \$25 million and has been determined to be a single performance obligation.

At the end of year one, when Construction Co. determines that it has satisfied 45% of its performance obligation, the customer requests a change order because it wants to be compliant with a new environmental standard and therefore will need to change (among other specifications) all the windows. The total cost to the customer for ensuring the building is compliant with this new standard will be an additional \$5 million, and the cost to Construction Co. will be \$4.5 million.

The changes required for compliance are not considered to be a distinct performance obligation. The contractor measures performance based on costs incurred. The modification will be accounted for as part of the existing contract and a cumulative catch-up adjustment will be required to revenue as follows:

	Original	Modified	Adjustment Required
Contract value	25,000,000	30,000,000	
Costs incurred to date	9,000,000	9,000,000	
Total expected cost	20,000,000	24,500,000	
% Estimate completed	45%	37%	
Gross margin %	20%	18%	
Revenue recognized	11,250,000	11,020,408	(\$229,592)

Transition

25. Transition²²

What are the transition options under IFRS 15? Are there benefits to selecting one transition option vs. the other?

IFRS 15 includes two transition options that may be used: 1) full retrospective and 2) “modified” retrospective.

Full Retrospective

Under this approach, IFRS 15 will be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, even if retrospectively applied (i.e., prior reporting periods would be restated), IFRS 15 offers a few practical expedients.

PRACTICAL EXPEDIENT(S)!



- Any completed²³ contracts that begin and end within the same annual reporting period do not need to be restated. Assuming a calendar-year-end entity, if a contract began on January 15, 2016, and ended on November 30, 2016, it would not need to be restated when the fiscal 2016 figures are being restated.²⁴
- For any completed contracts that included variable consideration, entities may use the transaction price on the contract completion date rather than estimating variable consideration amounts in the prior reporting periods. Effectively, this permits entities to use hindsight in estimating variable consideration and should simplify transition because it will reduce the amount of information required for transition and reduce efforts by not requiring entities to determine the transaction price at the end of each period.
- For all periods presented in the financial statements prior to the initial date of application (i.e., January 1, 2017, for a calendar-year-end entity), the disclosures of the amount of total consideration allocated to remaining performance obligations (and the required explanation of when it is expected to be recognized) do not need to be included.

Entities must apply the use of practical expedients consistently to contracts with similar characteristics and in similar circumstances.

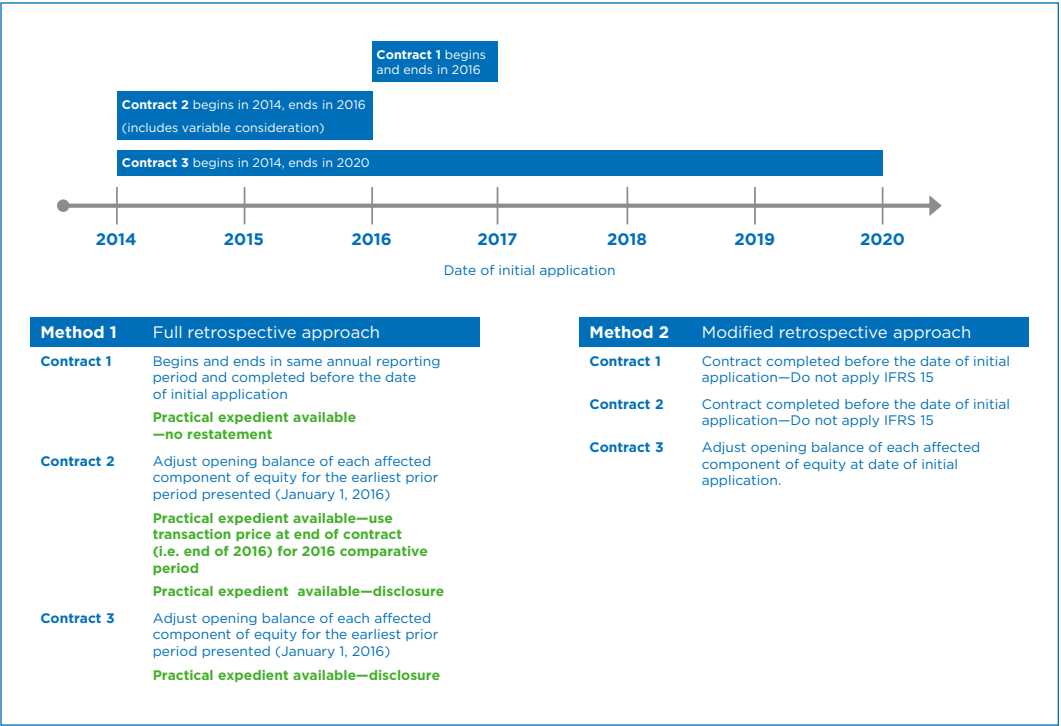
²² In April 2015, the IASB voted to publish an Exposure Draft proposing a one-year deferral of the effective date to January 1, 2018, with early application permitted. This discussion is based on the current effective date.

²³ Note—IFRS 15 defines “completed contracts” as “a contract for which the entity has transferred all of the goods or services identified in accordance with IAS 11, IAS 18 and related Interpretations”. Therefore a completed contract is one in which the entity has fully performed in accordance with the revenue recognition standard in effect before the initial date of application of IFRS 15. To the extent the entity’s performance is complete but there is a further change in transaction price in a particular contract, this is still viewed as a completed contract.

²⁴ Note—This is applicable in interim financial statements as well.

Modified Retrospective

Under this approach, rather than restating the comparative year (e.g., fiscal 2016), entities can recognize the cumulative effects of applying IFRS 15 as an adjustment to opening retained earnings in the period of initial application (i.e., January 1, 2017, for a calendar-year-end entity).



The transition method selected will depend on the particular circumstances, requirements and resources of each entity. No one method is particularly “better” than the other; however, there are advantages and disadvantages to each method. Some consideration points for each method have been listed in the table below:

Full Retrospective	Modified Retrospective
<ul style="list-style-type: none">This method should provide comparability for users of the financial statements so they can see trends, better understand results and possibly draw more meaningful conclusions, etc.Trend information may be diluted when certain practical expedients are applied.	<ul style="list-style-type: none">This method may not provide sufficient comparability. Therefore, users may not be able to make meaningful comparisons between fiscal years.

Full Retrospective	Modified Retrospective
<ul style="list-style-type: none"> This method should also require a significant amount of information that may have to be obtained from legacy systems. 	<ul style="list-style-type: none"> There should be no need for an entity to restate comparative years (i.e., current period will be IFRS 15, prior period will be legacy GAAP). Only contracts not completed at the date of initial application (i.e., the beginning of the year the revenue standard is first applied) will be adjusted. Therefore, less contracts to analyze. Entities must provide the following additional disclosures: <ul style="list-style-type: none"> amount by which each financial statement line item is affected in the current year as a result of applying the revenue standard (as compared to the previous revenue guidance) qualitative explanation of significant changes between the reported results under the revenue standard and the previous revenue standards. In order to obtain the information required for these disclosures, entities may effectively have to account for transactions under both standards (i.e., IAS 18/11 and IFRS 15). This could involve a significant amount of time and effort.

Presentation

26. Contract Asset

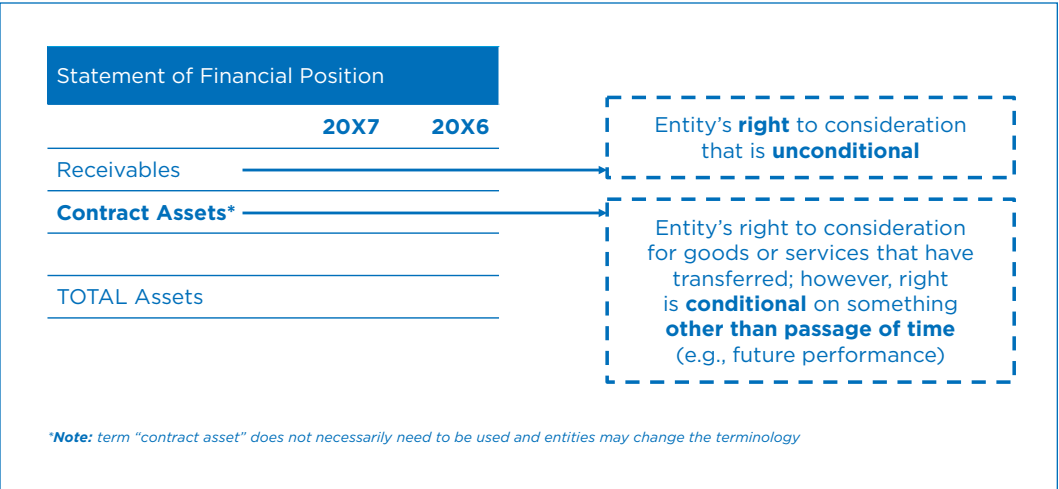
To what does the term “contract asset” refer? Are these simply receivables related to the contract?

A contract asset is not the same as an account receivable.

A contract asset is an entity's right to consideration in exchange for goods or services the entity has transferred to a customer, that is conditional on something other than the passage of time (e.g., the performance of another obligation). If the right to this consideration is *unconditional* and only the passage of time is required before the consideration is due, then a receivable exists and a contract asset does not exist.

A customer's right to a refund does not make such consideration conditional because future refunds do not affect an entity's present right to obtain consideration. Such obligations should be treated as a separate refund liability.

Both receivables and contract assets are subject to credit risk; however, contract assets are also subject to other types of risks, such as performance risk. Impairment losses relating to a customer’s credit risk (i.e., impairment of a contract asset or receivable) are measured based on the guidance in IFRS 9 *Financial Instruments*.



27. Bad Debts

How should “bad debts” be presented under IFRS 15? Are they offset against revenue?

“Bad debts” are recognized as a result of customer credit risk. However, this is not a credit risk existing at the inception of the contract and therefore is different from the evaluation of credit risk completed at inception (i.e., collectability threshold assessed as part of Step 1 of the IFRS 15 revenue model).

This topic was contemplated by the Boards in drafting IFRS 15. In the end, the Boards concluded that impairment losses (which may include bad debts) should be recognized as an expense.

Gross revenue is not adjusted for these amounts since revenue should be recognized at the amount at which the entity expects to be entitled (and not the amount it receives). This amount should not be adjusted by amounts the entity was not able to collect.

Additionally the portion of the impairment losses recognized that relate to short-term receivables from contracts with customers (i.e., effectively bad debts) should be disclosed separately in the financial statements notes (i.e., separate from other impairment losses), since this provides users with information on receivables management (i.e., bad debts).

This approach provides both sufficient information and transparency so users can identify trends and draw on other information related to revenue and credit management separately.

Disclosure

28. Disclosure

What types of disclosure are required under IFRS 15 and how do these requirements compare to existing disclosure requirements?

The disclosure requirements in IFRS 15 have increased significantly compared to the disclosure requirements under the existing IFRS revenue standards.

The purpose of such disclosures is to provide sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The level of detail required in applying these disclosures will require professional judgment.

Disclosures can be broken down into a few main categories: contracts with customers, significant judgments in the application IFRS 15, assets recognized from the costs to obtain or fulfill a contract with a customer, and practical expedients. The following are some selected disclosure requirements:

Contracts with Customers

For all contracts with customers within the scope of IFRS 15, entities must disclose:

- amount of revenue recognized (which must be disclosed separately from other revenue sources)
- impairment losses recognized on any receivables or contract assets.

If these amounts are already presented in the *Statement of Comprehensive Income*, the above additional disclosures are not required.

Significant Judgments in the Application of IFRS 15

Focus should be on judgments and changes in judgments used to determine:

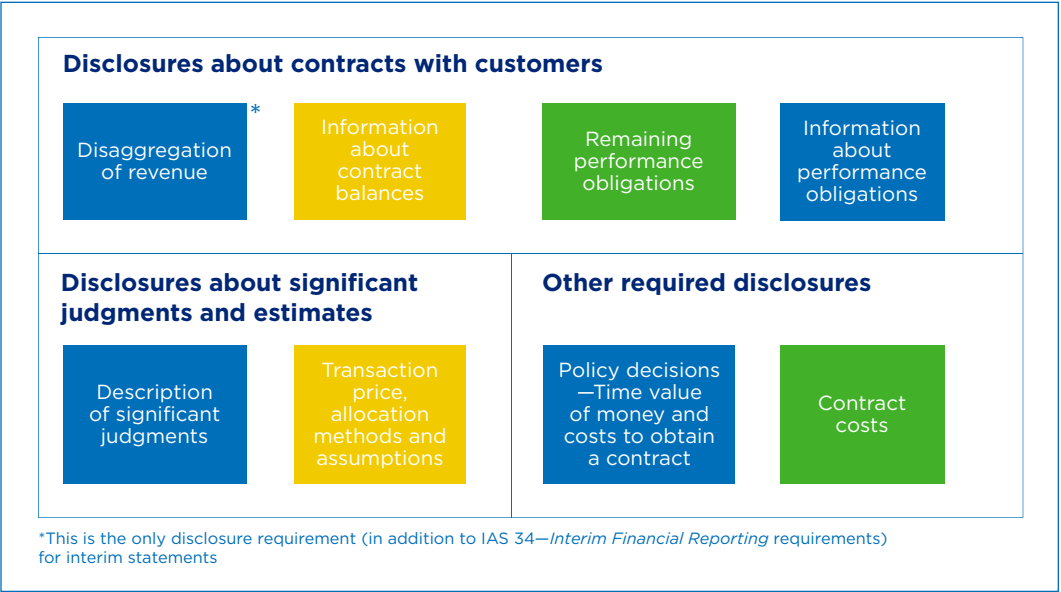
- timing of satisfaction of performance obligations
- transaction price and amounts allocated to performance obligations.

Assets Recognized from the Costs to Obtain or Fulfill a Contract with a Customer

Disclosures should include the judgments required to determine the amount of the costs incurred to obtain or fulfil a contract with a customer, the method used for amortization, the closing balances of these assets by main category and the amount of amortization and impairment (if any) recognized during the period.

Practical Expedients

If any practical expedients are used, these should be disclosed.



Application Resources

29. IFRS vs. U.S. GAAP

What are some of the differences between IFRS 15 and the U.S. GAAP equivalent, ASU 2014-09, Topic 606?

These differences²⁵ are discussed in more detail in Appendix A of the Basis for Conclusions on IFRS 15. However, at a high level, the differences are as follows:

25 Note—Other differences may exist because of the interaction between the revenue standard and other standards within each framework, as well as additional amendments that may be made to the standards. These are not further discussed.

Subject	IFRS 15	U.S. GAAP (Topic 606)
Collectability threshold <i>The term “probable” is used in assessing collectability of consideration, as part of one of the five minimum requirements for a contract to exist.</i>	<ul style="list-style-type: none"> Probable means “more than likely to occur”, which is generally interpreted as more than 50%. 	<ul style="list-style-type: none"> In U.S. GAAP, the collectability threshold is not clearly defined but interpreted to generally be somewhat greater than 50%.
Interim disclosure requirements	<ul style="list-style-type: none"> IAS 34 <i>Interim Financial Reporting</i> has been amended to require disclosure of disaggregated revenue information from contracts with customers. 	<ul style="list-style-type: none"> U.S. GAAP also requires disclosure in interim reports (i.e., similar to IAS 34 amendment). However, information about contract balances and remaining performance obligations are also required to be disclosed.
Early application and effective date ²⁶	<ul style="list-style-type: none"> Early application is permitted. Mandatory effective date of annual reporting periods beginning on or after January 1, 2017. 	<ul style="list-style-type: none"> Early application is not permitted. The mandatory effective date (for public entities) for annual periods begins on or after December 15, 2016.
Impairment loss reversal	<ul style="list-style-type: none"> Impairment losses must be reversed when impairment conditions no longer exist or have improved. 	<ul style="list-style-type: none"> There is no reversal of impairment losses.
Non-public entity requirements	<ul style="list-style-type: none"> There are no specific requirements. 	<ul style="list-style-type: none"> U.S. GAAP applies to non-public entities, with some specific relief related to disclosures, transition and the effective date.

30. Other Resources

There seem to be various forums and resources where issues and stakeholder questions/concerns may be addressed. How should the information and discussion from these forums be considered in interpreting and applying IFRS 15?

This issue was discussed at the [December 2014 IFRS Discussion Group \(IDG\) meeting](#) where the paper being discussed questioned whether non-authoritative literature needs to be followed when preparing financial statements.

²⁶ In April 2015, the IASB voted to publish an Exposure Draft proposing a one-year deferral of the effective date to January 1, 2018, with early application permitted. This discussion is based on the current effective date.

For revenue specifically, there are a number of forums where issues may be discussed, as follows:

Forum	Authoritative?	Additional information and/or Resources
FASB/IASB Joint Transition Resource Group for Revenue Recognition (TRG)	No. NOTE: Although non-authoritative, stakeholders need to remain informed of the activities of the TRG since an issue raised in this forum may lead to further interpretation by the Boards in due course.	Groups including financial statement preparers, auditors and users who have significant knowledge and experience with revenue recognition and solicit, analyze and discuss stakeholder issues related to IFRS 15/ASU 2014-09 (Topic 606). Based on these discussions, the TRG informs the Boards about implementation issues which it determines may require further clarification or consideration on the part of the Boards. Some of the discussions of the TRG have been referenced throughout this publication. For more information visit: www.ifrs.org/About-us/IASB/Advisory-bodies/Joint-Revenue-Transition-Resource-Group/Pages/Home.aspx
IFRIC (Note: No IFRS 15 issues have gone to the IFRIC yet).	Yes (if an interpretation is written).	Interpretative body of the IFRS Foundation that reviews on a timely basis widespread accounting issues that have arisen within the context of current International Financial Reporting Standards (IFRSs). For more information visit: www.ifrs.org/The-organisation/Members-of-the-IFRIC/Pages/About-the-IFRIC.aspx
AICPA Industry Task Forces	No.	AICPA (American Institute of Certified Public Accountants) has formed 16 industry task forces that will be developing industry-specific accounting guides on revenue recognition specific to those industries. For more information: www.aicpa.org/INTERESTAREAS/FRC/ACCOUNTINGFINANCIALREPORTING/REVENUERECOGNITION/Pages/RevenueRecognition.aspx
IFRS Discussion Group	No.	Established by the Canadian Accounting Standards Board for the purpose of implementing and maintaining a regular public forum to discuss issues that arise in Canada when applying IFRSs. For more information: www.frscanada.ca/international-financial-reporting-standards/ifrs-discussion-group/about-the-group/index.aspx

Some additional resources that are quite useful in understanding IFRS 15 and in addressing some questions that may arise are the Basis for Conclusions on IFRS 15 and the Illustrative Examples accompanying IFRS 15.

Although not part of IFRS 15, the Basis for Conclusions on IFRS 15 provides the reasons behind the Boards' accepting and rejecting particular views which may assist in gaining additional insights on the application of certain areas of IFRS 15.

Similarly, the Illustrative Examples, although not intended to provide interpretative guidance, provide hypothetical situations on how entities may apply the requirements of IFRS 15 in particular fact patterns.

CPA Canada Resources

CPA Canada has compiled various external IFRS technical summaries, practical application guides and frequently-asked-questions documents aimed at supporting the understanding and application of IFRS 15. For example:

- ***Financial Reporting Alert: IFRS 15 Revenue from Contracts with Customers***
- ***Webinar—IFRS 15 Revenue from Contracts with Customers***

To access our online library of IFRS resources, visit www.cpacanada.ca/ifrs15resources



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