

FINANCIAL ACCOUNTING SERIES



EXPOSURE DRAFT

Proposed Accounting Standards Update (Revised)

Issued: November 14, 2011
Comments Due: March 13, 2012

Revenue Recognition (Topic 605)

Revenue from Contracts with Customers

Revision of Exposure Draft
Issued June 24, 2010

This revised Exposure Draft of a proposed Accounting Standards Update of Topic 605 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. 2011-230

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by March 13, 2012. Interested parties may submit comments in one of three following ways:

- Using the electronic feedback form available on the FASB website at [Exposure Documents Open for Comment](#)
- Emailing a written letter to director@fasb.org, File Reference No. 2011-230
- Sending written comments to “Technical Director, File Reference No. 2011-230, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.”

Do not send responses by fax.

All comments received are part of the FASB’s public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Update?

Revenue is a crucial number to users of financial statements in assessing an entity's financial performance and position. However, revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRSs), and both sets of requirements need improvement. U.S. GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions. Although IFRSs have fewer requirements on revenue recognition, the two main revenue recognition standards, IAS 18, *Revenue*, and IAS 11, *Construction Contracts*, can be difficult to understand and apply. In addition, IAS 18 provides limited guidance on important topics such as revenue recognition for multiple-element arrangements.

Accordingly, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRSs that would:

1. Remove inconsistencies and weaknesses in existing revenue requirements.
2. Provide a more robust framework for addressing revenue issues.
3. Improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.
4. Provide more useful information to users of financial statements through improved disclosure requirements.
5. Simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

To meet those objectives, the FASB and the IASB are proposing amendments to the *FASB Accounting Standards Codification*[®] and to IFRSs, respectively.

In December 2008, the Boards published the Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers*. The Discussion Paper explained the Boards' initial views on revenue, including some of the principles that they proposed as the basis of a future standard. After considering feedback received on the Discussion Paper, the Boards developed those principles into a draft standard.

In June 2010, the Boards issued the Exposure Draft, *Revenue from Contracts with Customers*. (The FASB's version was a proposed Accounting Standards Update.) The Boards received nearly 1,000 comment letters on the 2010

proposed Update and, in response, have revised various aspects of the June 2010 proposals. (Appendix B of this proposed Update summarizes those revisions.) Although those revisions did not necessitate reexposure for public comment in accordance with the Boards' due process procedures, the Boards decided to reexpose the proposals because of the importance to all entities of the financial reporting of revenue and the desire to avoid unintended consequences of the final standard.

Who Would Be Affected by the Amendments in This Proposed Update?

The guidance in this proposed Update would affect any entity that enters into contracts with customers unless those contracts are in the scope of other standards (for example, insurance contracts or lease contracts).

In U.S. GAAP, the guidance in this proposed Update would supersede most of the revenue recognition requirements in Topic 605 (and related guidance). In IFRSs, the guidance in this proposed Update would supersede IASs 11 and 18 (and related Interpretations).

In addition, the existing requirements for the recognition of a gain or loss on the transfer of some nonfinancial assets that are not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, *Property, Plant and Equipment*, or IAS 40, *Investment Property*) would be amended to be consistent with the proposed recognition and measurement guidance in this proposed Update.

What Are the Main Provisions?

The core principle of this proposed guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

To achieve that core principle, an entity would apply all of the following steps:

1. Step 1: Identify the contract with a customer.
2. Step 2: Identify the separate performance obligations in the contract.
3. Step 3: Determine the transaction price.
4. Step 4: Allocate the transaction price to the separate performance obligations in the contract.
5. Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Step 1: Identify the contract with a customer

A contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral, or implied by an entity's customary business practices. An entity would apply the proposed revenue guidance to each contract with a customer unless specified criteria are met for the combination of contracts.

Step 2: Identify the separate performance obligations in the contract

A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. If an entity promises to transfer more than one good or service, the entity would account for each promised good or service as a separate performance obligation only if it is distinct. If a promised good or service is not distinct, an entity would combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in a contract as a single performance obligation.

A good or service is distinct if either of the following criteria is met:

1. The entity regularly sells the good or service separately.
2. The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.

Notwithstanding those criteria, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity would account for the bundle as a single performance obligation, if both of the following criteria are met:

1. The goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted.
2. The bundle of goods or services is significantly modified or customized to fulfill the contract.

The proposed guidance also includes implementation guidance to help an entity to appropriately identify the performance obligations in specified situations (for example, when other parties are involved in providing goods to an entity's customer and the entity must determine whether its performance obligation is to provide the goods, by acting as a principal, or to provide the service of arranging for another party to provide the goods by acting as an agent).

Step 3: Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a

customer, excluding amounts collected on behalf of third parties (for example, sales taxes). When determining the transaction price, an entity would consider the effects of all of the following:

1. Variable consideration—If the promised amount of consideration in a contract is variable, an entity would estimate the transaction price by using either the expected value (that is, probability-weighted amount) or the most likely amount, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled.
2. The time value of money—An entity would adjust the promised amount of consideration to reflect the time value of money if the contract has a financing component that is significant to the contract. An entity would consider various factors in assessing whether a financing component is significant to a contract. As a practical expedient, an entity need not adjust the promised amount of consideration to reflect the time value of money if the entity expects at contract inception that the period between payment by the customer and the transfer of the promised goods or services to the customer will be one year or less.
3. Noncash consideration—If a customer promises consideration in a form other than cash, an entity would measure the noncash consideration (or promise of noncash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the noncash consideration, it would measure the consideration indirectly by reference to the standalone selling price of the goods or services promised to the customer in exchange for the consideration.
4. Consideration payable to the customer—If an entity pays, or expects to pay, consideration to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash, credit, or other items that the customer can apply against amounts owed to the entity, the entity would account for the consideration payable to the customer as a reduction of the transaction price unless the payment is in exchange for a distinct good or service.

An entity would not consider the effects of customer credit risk (that is, collectibility) when determining the transaction price but, instead, would account for those effects by applying the guidance in Topic 310 on receivables or IFRS 9, *Financial Instruments*. Any corresponding amounts recognized in profit or loss would be presented both initially and subsequently as a separate line item adjacent to the revenue line item.

Step 4: Allocate the transaction price to the separate performance obligations in the contract

For a contract that has more than one separate performance obligation, an entity would allocate the transaction price to each separate performance obligation in

an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.

To allocate an appropriate amount of consideration to each separate performance obligation, an entity would determine the standalone selling price at contract inception of the good or service underlying each separate performance obligation and allocate the transaction price on a relative standalone selling price basis. If a standalone selling price is not observable, an entity would estimate it.

The proposed guidance specifies the circumstances in which an entity would allocate a discount or a contingent amount entirely to one (or some) distinct goods or services promised in a contract rather than to all promised goods or services in the contract.

An entity would allocate to the separate performance obligations in a contract any subsequent changes in the transaction price on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation would be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation

An entity would recognize revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when (or as) the customer obtains control of that good or service.

For each separate performance obligation, an entity would determine whether the entity satisfies the performance obligation over time by transferring control of a good or service over time. If the entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognizes revenue over time if at least one of the following two criteria is met:

1. The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced.
2. The entity's performance does not create an asset with an alternative use to the entity and at least one of the following criteria is met:
 - (a) The customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs.
 - (b) Another entity would not need to substantially reperform the work the entity has completed to date if that other entity were to fulfill the remaining obligation to the customer.
 - (c) The entity has a right to payment for performance completed to date and it expects to fulfill the contract as promised.

For each separate performance obligation that an entity satisfies over time, the entity would recognize revenue over time by consistently applying a method of measuring the progress toward complete satisfaction of that performance obligation. Appropriate methods of measuring progress include output methods and input methods. As circumstances change over time, an entity would update its measure of progress to depict the entity's performance completed to date.

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time. To determine the point in time when a customer obtains control of a promised asset and an entity satisfies a performance obligation, the entity would consider indicators of the transfer of control that include, but are not limited to, the following:

1. The entity has a present right to payment for the asset.
2. The customer has legal title to the asset.
3. The entity has transferred physical possession of the asset.
4. The customer has the significant risks and rewards of ownership of the asset.
5. The customer has accepted the asset.

In addition, the proposed guidance includes implementation guidance on specified topics (for example, repurchase agreements, consignment arrangements, and bill-and-hold arrangements) to help an entity determine when control of a promised good or service is transferred to a customer.

Constraint on the cumulative amount of revenue recognized

If the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date would not exceed the amount to which it is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

1. The entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities).
2. The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

An entity would be required to consider various factors when determining whether the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled.

Onerous performance obligations

For a performance obligation that an entity satisfies over time and that the entity expects at contract inception to satisfy over a period of time greater than one

year, an entity would recognize a liability and a corresponding expense if the performance obligation is onerous.

A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation. The proposed guidance specifies how an entity would determine the lowest cost of settling the performance obligation.

Contract costs

The proposed guidance also specifies the accounting for some costs of obtaining or fulfilling a contract with a customer. An entity would recognize as an asset the incremental costs of obtaining a contract if the entity expects to recover those costs. To account for the costs of fulfilling a contract with a customer, an entity would apply the requirements of other standards (for example, Topic 330 on inventory or IAS 2, *Inventories*; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), if applicable. Otherwise, an entity would recognize an asset from the costs to fulfill a contract only if those costs meet all of the following criteria:

1. The costs relate directly to a contract (or a specific anticipated contract).
2. The costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future.
3. The costs are expected to be recovered.

Disclosures

The proposed guidance specifies various disclosure requirements that would enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity would disclose qualitative and quantitative information about all of the following:

1. Its contracts with customers (including a reconciliation of contract balances)
2. The significant judgments, and changes in judgments, made in applying the proposed guidance to those contracts
3. Any assets recognized from the costs to obtain or fulfill a contract with a customer.

In addition, the Boards propose amending Topic 270 on interim reporting and IAS 34, *Interim Financial Reporting*, to require some information to be disclosed for interim reporting periods.

A nonpublic entity may elect not to provide some of the proposed disclosures (for example, a reconciliation of contract balances).

When Would the Provisions Be Effective?

The Boards decided that on the basis of their current timetable for the project, a final revenue standard would not be effective earlier than for annual reporting periods beginning on or after January 1, 2015. That timing would ensure that for an entity providing two years of comparative annual financial information (in addition to information for the current year), the standard would be issued before the beginning of the earliest comparative annual period presented. The FASB decided that early application would not be permitted. The IASB decided that early application would be permitted.

Questions for Respondents

Much of the guidance in this proposed Update is similar to the guidance in the 2010 proposed Update on which the Boards have received extensive feedback. Hence, the Boards are not seeking specific comments on all matters in this proposed Update. Instead, the Boards invite individuals and organizations to comment on whether the proposed guidance is clear and can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers. If a proposed requirement is not clear, the Boards invite suggestions on how to clarify the drafting of the proposed requirement. The Boards also invite comments on the specific questions below. Respondents need not comment on all of the questions.

Comments are requested from both those who agree with the proposed guidance and those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with a proposal are asked to describe their suggested alternative(s), supported by specific reasoning.

Respondents should submit one comment letter to either the FASB or the IASB. The Boards will share and jointly consider all comment letters received.

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognizes revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

Question 2: Paragraphs 68 and 69 state that an entity would apply Topic 310 (or IFRS 9, if applicable) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognize a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

Question 5: The Boards propose to amend Topic 270 and IAS 34 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements. The disclosures that would be required (if material) are:

1. The disaggregation of revenue (paragraphs 114–116)
2. A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
3. An analysis of the entity's remaining performance obligations (paragraphs 119–121)
4. Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
5. A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial statements? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

Question 6: For the transfer of a nonfinancial asset that is not an output of an entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360, IAS 16, or IAS 40), the Boards propose amending other standards to require that an entity apply (a) the proposed guidance on control to determine when to derecognize the asset and (b) the proposed measurement guidance to determine the amount of gain or loss to recognize upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement guidance to account for the transfer of nonfinancial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

Proposed Guidance

Introduction

1. In accordance with FASB Concepts Statement No. 6, *Elements of Financial Statements*, revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations. The assets increased by revenues may be of various kinds, for example, cash, claims against customers, inventory, or other assets.
2. This proposed guidance specifies the accounting for revenue arising from contracts with customers. It does not address revenue arising from other transactions or activities (for example, revenues arising from changes in the value of some biological or agricultural assets).
3. The core principle of this proposed guidance is that an entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.
4. To achieve that core principle, an entity shall apply all of the following steps:
 - (a) Identify the contract with a customer.
 - (b) Identify the separate performance obligations in the contract.
 - (c) Determine the transaction price.
 - (d) Allocate the transaction price to the separate performance obligations in the contract.
 - (e) Recognize revenue when (or as) the entity satisfies a performance obligation.
5. An entity shall consider the terms of the contract and all related facts and circumstances when using judgment in applying this proposed guidance. An entity shall apply this proposed guidance consistently to contracts with similar characteristics and in similar circumstances.
6. This proposed guidance specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this proposed guidance to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this proposed guidance to the individual contracts (or performance obligations).

7. This proposed guidance uses the terms in Appendix A with the specified meanings. Terms defined in Appendix A (the glossary) are in **bold type** the first time they appear. Paragraphs in **bold type** state the main principles. (Glossary terms that appear for the first time in a principle paragraph are in plain type.)

Objective

8. The objective of this proposed guidance is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of **revenue** and cash flows arising from a **contract** with a **customer**.

Scope

9. An entity shall apply this proposed guidance to all contracts with customers, except the following:
 - (a) Lease contracts within the scope of Topic 840 on leases
 - (b) Insurance contracts within the scope of Topic 944 on insurance
 - (c) Contractual rights or obligations within the scope of the following Topics:
 - (i) Topic 310 on receivables
 - (ii) Topic 320 on debt and equity securities
 - (iii) Topic 405 on liabilities
 - (iv) Topic 470 on debt
 - (v) Topic 815 on derivatives and hedging
 - (vi) Topic 825 on financial instruments
 - (vii) Topic 860 on transfers and servicing.
 - (d) Guarantees (other than product or service warranties) within the scope of Topic 460 on guarantees
 - (e) Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers, other than the parties to the exchange (for example, an exchange of oil to fulfill demand on a timely basis in a specified location).
10. A customer is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. An entity shall apply this proposed guidance to a contract (other than a contract listed in paragraph 9) only if the counterparty to the contract is a customer. For some contracts, the counterparty to the contract might not be a customer but rather a collaborator or a partner that shares with the entity the risks and benefits of developing a product to be marketed. Such contracts are not in the scope of this proposed guidance.

11. A contract with a customer may be partially within the scope of this proposed guidance and partially within the scope of other standards.
 - (a) If the other standards specify how to separate and/or initially measure one or more parts of the contract, then an entity shall first apply those separation and/or measurement requirements.
 - (b) If the other standards do not specify how to separate and/or initially measure one or more parts of the contract, then the entity shall apply this proposed guidance to separate and/or initially measure the part(s) of the contract.

Recognition of revenue

Identifying the contract

12. **An entity shall apply this proposed guidance to each contract identified in accordance with paragraphs 13–22.**
13. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability is a matter of law. Contracts can be written, oral, or implied by an entity's customary business practices. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities. Additionally, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining when an agreement with a customer creates enforceable rights and obligations of the entity.
14. An entity shall apply the proposed revenue guidance to a contract with a customer only if all of the following criteria are met:
 - (a) The contract has commercial substance (that is, the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract).
 - (b) The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
 - (c) The entity can identify each party's rights regarding the goods or services to be transferred.
 - (d) The entity can identify the payment terms for the goods or services to be transferred.
15. For the purpose of applying the proposed revenue guidance, a contract does not exist if each party to the contract has the unilateral enforceable right to terminate a wholly unperformed contract without compensating

the other party (parties). A contract is wholly unperformed if both of the following criteria are met:

- (a) The entity has not yet transferred any promised goods or services to the customer.
- (b) The entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.

Combination of contracts

- 16. An entity shall apply this proposed guidance to each contract with a customer except as specified in paragraphs 6 and 17.
- 17. An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties) and account for the contracts as a single contract if one or more of the following criteria are met:
 - (a) The contracts are negotiated as a package with a single commercial objective.
 - (b) The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
 - (c) The goods or services promised in the contracts (or some goods or services promised in the contracts) are a single **performance obligation** in accordance with paragraphs 27–30.

Contract modifications (see paragraph IG61)

- 18. A contract modification exists when the parties to a contract approve a change in the scope or price of a contract (or both). If a contract modification has not been approved by the parties to a contract, an entity shall continue to apply the proposed revenue guidance to the existing contract until the contract modification is approved.
- 19. If the parties to a contract have approved a change in the scope of the contract but have not yet determined the corresponding change in price, an entity shall apply the proposed revenue guidance to the modified contract when the entity has an expectation that the price of the modification will be approved. To estimate the **transaction price** in such cases, an entity shall apply the proposed guidance in paragraphs 50–67.
- 20. If a contract modification results only in a change to the transaction price, an entity shall account for the modification as a change in the transaction price in accordance with paragraphs 77–80.
- 21. An entity shall account for a contract modification as a separate contract if the contract modification results in the addition to the contract of both of the following:

- (a) Promised goods or services that are distinct in accordance with paragraphs 27–30
 - (b) An entity's right to receive an amount of consideration that reflects the entity's **standalone selling price** of the promised good(s) or service(s) and any appropriate adjustments to that price to reflect the circumstances of the particular contract. For example, an entity would adjust the standalone selling price for a discount that the customer receives because it is not necessary for the entity to incur the selling-related costs that it would incur when selling a similar good or service to a new customer.
22. For a contract modification that is not a separate contract in accordance with paragraph 21, an entity shall evaluate the remaining goods or services in the modified contract (that is, the promised goods or services not yet transferred at the date of the contract modification) and shall account for the modified contract in whichever of the following ways is applicable:
- (a) If the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification, then the entity shall allocate to the remaining separate performance obligations the amount of consideration received from the customer but not yet recognized as revenue plus the amount of any remaining consideration that the customer has promised to pay. In effect, an entity shall account for the contract modification as a termination of the original contract and the creation of a new contract.
 - (b) If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied at the date of the contract modification, then the entity shall update the transaction price and the measure of progress toward complete satisfaction of the performance obligation. The entity shall recognize the effect of the contract modification as revenue (or as a reduction of revenue) at the date of the contract modification on a cumulative catch-up basis. In effect, the entity shall account for the contract modification as if it were a part of the original contract.
 - (c) If the remaining goods or services are a combination of items (a) and (b), then the entity shall allocate to the unsatisfied (including partially unsatisfied) separate performance obligations the amount of consideration received from the customer but not yet recognized as revenue plus the amount of any remaining consideration that the customer has promised to pay. For a performance obligation satisfied over time, an entity shall update the transaction price and the measure of progress toward complete satisfaction of the performance obligation. An entity

shall not reallocate consideration to, and adjust the amount of revenue recognized for, separate performance obligations that are completely satisfied on or before the date of the contract modification.

Identifying separate performance obligations (see paragraphs IG16, IG20, and IG62)

23. **An entity shall evaluate the goods or services promised in a contract and shall identify which goods or services (or which bundles of goods or services) are distinct and, hence, that the entity shall account for as a separate performance obligation.**
24. A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer. Performance obligations include promises that are implied by an entity's customary business practices, published policies, or specific statements if those promises create a valid expectation of the customer that the entity will transfer a good or service.
25. Performance obligations do not include activities that an entity must undertake to fulfill a contract unless the entity transfers a good or service to the customer as those activities occur. For example, a services provider may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the customer as the tasks are performed. Hence, those promised setup activities are not a performance obligation.
26. Depending on the contract, promised goods or services may include, but are not limited to, the following:
 - (a) Goods produced by an entity for sale (for example, inventory of a manufacturer)
 - (b) Goods purchased by an entity for resale (for example, merchandise of a retailer)
 - (c) Providing a service of arranging for another party to transfer goods or services to the customer (for example, acting as an agent of another party as discussed in paragraphs IG16–IG19)
 - (d) Standing ready to provide goods or services (for example, when-and-if-available software products)
 - (e) Constructing, manufacturing, or developing an asset on behalf of a customer
 - (f) Granting licenses or rights to use intangible assets
 - (g) Granting options to purchase additional goods or services (when those options provide the customer with a material right as discussed in paragraphs IG20–IG22)

- (h) Performing a contractually agreed-upon task (or tasks) for a customer.
27. If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in a contract as a single performance obligation.
28. Except as specified in paragraph 29, a good or service is distinct if either of the following criteria is met:
- (a) The entity regularly sells the good or service separately.
 - (b) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer already has obtained (from the entity or from other transactions or events).
29. Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both of the following criteria are met:
- (a) The goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating the goods or services into the combined item(s) for which the customer has contracted.
 - (b) The bundle of goods or services is significantly modified or customized to fulfill the contract.
30. As a practical expedient, an entity may account for two or more distinct goods or services promised in a contract as a single performance obligation if those goods or services have the same pattern of transfer to the customer. For example, if an entity promises to transfer two or more distinct services to a customer over the same period of time, the entity could account for those promises as one performance obligation if applying one method of measuring progress (as discussed in paragraphs 38–48) would faithfully depict the pattern of transfer of those services to the customer.

Satisfaction of performance obligations (see paragraphs IG63 and IG64)

31. **An entity shall recognize revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (that is, an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.**
32. Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset. The benefits of an asset are the potential cash flows that can be obtained directly or indirectly in many ways, such as by:
 - (a) Using the asset to produce goods or provide services (including public services)
 - (b) Using the asset to enhance the value of other assets
 - (c) Using the asset to settle liabilities or reduce expenses
 - (d) Selling or exchanging the asset
 - (e) Pledging the asset to secure a loan
 - (f) Holding the asset.
33. When evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the promised asset or a component of the promised asset. (See the implementation guidance on repurchase agreements in paragraphs IG38–IG48.)
34. For each separate performance obligation identified in paragraphs 23–30, an entity shall apply the guidance in paragraphs 35 and 36 to determine at contract inception whether the entity satisfies the performance obligation over time by transferring control of a promised good or service over time. If an entity does not satisfy a performance obligation over time, the performance obligation is satisfied at a point in time.

Performance obligations satisfied over time

35. An entity transfers control of a good or service over time and, hence, satisfies a performance obligation and recognizes revenue over time if at least one of the following two criteria is met:
 - (a) The entity's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced. An entity shall apply the proposed guidance on control in paragraphs 31–33 and paragraph 37 to

determine whether the customer controls an asset as it is created or enhanced.

- (b) The entity's performance does not create an asset with an alternative use to the entity (see paragraph 36) and at least one of the following criteria is met:
 - (i) The customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs.
 - (ii) Another entity would not need to substantially reperform the work the entity has completed to date if that other entity were to fulfill the remaining obligation to the customer. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset (for example, work in process) presently controlled by the entity. In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity.
 - (iii) The entity has a right to payment for performance completed to date, and it expects to fulfill the contract as promised. The right to payment for performance completed to date does not need to be for a fixed amount. However, the entity must be entitled to an amount that is intended to at least compensate the entity for performance completed to date even if the customer can terminate the contract for reasons other than the entity's failure to perform as promised. Compensation for performance completed to date includes payment that approximates the selling price of the goods or services transferred to date (for example, recovery of the entity's costs plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract is terminated.
36. When evaluating whether an asset has an alternative use to the entity, an entity shall consider at contract inception the effects of contractual and practical limitations on the entity's ability to readily direct the promised asset to another customer. A promised asset would not have an alternative use to an entity if the entity is unable, either contractually or practically, to readily direct the asset to another customer. For example, an asset would have an alternative use to an entity if the asset is largely interchangeable with other assets that the entity could transfer to the customer without breaching the contract and without incurring significant costs that otherwise would not have been incurred in relation to that contract. Conversely, the asset would not have an alternative use if the contract has substantive terms that preclude the entity from

directing the asset to another customer or if the entity would incur significant costs (for example, costs to rework the asset) to direct the asset to another customer.

Performance obligations satisfied at a point in time (see paragraphs IG38–IG58)

37. If a performance obligation is not satisfied over time in accordance with paragraphs 35 and 36, an entity satisfies the performance obligation at a point in time. To determine the point in time when a customer obtains control of a promised asset and an entity satisfies a performance obligation, the entity shall consider the guidance on control in paragraphs 31–33. In addition, an entity shall consider indicators of the transfer of control, which include, but are not limited to, the following:
- (a) The entity has a present right to payment for the asset—If a customer presently is obliged to pay for an asset, then that indicates that the customer has obtained control of the asset in exchange.
 - (b) The customer has legal title to the asset—Legal title often indicates which party to a contract has the ability to direct the use of and obtain the benefits from an asset or to restrict the access of other entities to those benefits. Hence, the transfer of legal title of an asset indicates that the customer has obtained control of the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity are protective rights and do not preclude a customer from obtaining control of an asset.
 - (c) The entity has transferred physical possession of the asset—The customer's physical possession of an asset indicates that the customer has the ability to direct the use of and obtain the benefits from the asset or to restrict the access of other entities to those benefits. However, physical possession may not coincide with control of an asset. For example, in some repurchase agreements and in some consignment arrangements, a customer or consignee may have physical possession of an asset that the entity controls. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of an asset that the customer controls. To account for a repurchase, consignment, or bill-and-hold arrangement, an entity shall apply the implementation guidance in paragraphs IG38–IG54.
 - (d) The customer has the significant risks and rewards of ownership of the asset—The transfer of the significant risks and rewards of ownership of an asset to the customer indicates that control of the asset has been transferred. However, when evaluating the risks and rewards of ownership of a promised asset, an entity

shall consider any risks that may give rise to a separate performance obligation in addition to the performance obligation to transfer the asset. For example, an entity may have transferred control of an asset to a customer but not yet satisfied an additional separate performance obligation to provide maintenance services related to the transferred asset.

- (e) The customer has accepted the asset—The customer's acceptance of an asset indicates that it has obtained the ability to direct the use of and obtain the benefits from the asset. To evaluate the effect of a contractual customer acceptance clause on when control of an asset is transferred, an entity shall consider the implementation guidance in paragraphs IG55–IG58.

Measuring progress toward complete satisfaction of a performance obligation (see paragraph IG65)

- 38. For each separate performance obligation that an entity satisfies over time in accordance with paragraphs 35 and 36, an entity shall recognize revenue over time by measuring the progress toward complete satisfaction of that performance obligation. The objective when measuring progress is to depict the transfer of control of goods or services to the customer—that is, to depict an entity's performance. As circumstances change over time, an entity shall update its measure of progress to depict the entity's performance completed to date. Such changes shall be accounted for as a change in accounting estimate in accordance with Subtopic 250-10 on accounting changes and error corrections.
- 39. In accordance with the objective of measuring progress, an entity shall exclude from a measure of progress any goods or services for which the entity does not transfer control to the customer. Conversely, an entity shall include in the measure of progress any goods or services for which the entity does transfer control to the customer.
- 40. For each separate performance obligation satisfied over time, an entity shall apply a method of measuring progress that is consistent with the objective in paragraph 38 and shall apply that method consistently to similar performance obligations and in similar circumstances. Appropriate methods of measuring progress include output methods and input methods.

Output methods

- 41. Output methods recognize revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date

(for example, surveys of performance completed to date, appraisals of results achieved, milestones reached, or units produced) and can be the most faithful depiction of the entity's performance.

42. If an entity has a right to invoice a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date (for example, a services contract in which an entity bills a fixed amount for each hour of service provided), the entity shall recognize revenue in the amount to which the entity has a right to invoice.
43. A disadvantage of output methods is that they often are not directly observable and the information required to apply them may not be available to the entity without undue cost. Hence, an input method may be necessary.

Input methods

44. Input methods recognize revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labor hours expended, costs incurred, time lapsed, or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation. If the entity's efforts or inputs are expended evenly throughout the performance period, it may be appropriate for an entity to recognize revenue on a straight-line basis.
45. A shortcoming of input methods is that there may not be a direct relationship between the entity's inputs and the transfer of control of goods or services to the customer because of inefficiencies in the entity's performance or other factors. Hence, when using an input method, an entity shall exclude the effects of any inputs that do not depict the transfer of control of goods or services to the customer (for example, the costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract).
46. When applying an input method to a separate performance obligation that includes goods that the customer obtains control of significantly before receiving services related to those goods, the best depiction of the entity's performance may be for the entity to recognize revenue for the transferred goods in an amount equal to the costs of those goods if both of the following conditions are present at contract inception:
 - (a) The cost of the transferred goods is significant relative to the total expected costs to completely satisfy the performance obligation.
 - (b) The entity procures the goods from another entity and is not significantly involved in designing and manufacturing the goods

(but the entity is acting as a principal in accordance with paragraphs IG16–IG19).

Reasonable measures of progress

47. An entity shall recognize revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress toward complete satisfaction of the performance obligation. An entity would not be able to reasonably measure its progress toward complete satisfaction of a performance obligation if it lacks reliable information that would be required to apply an appropriate method of measuring progress.
48. In some circumstances (for example, in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but the entity expects to recover the costs incurred in satisfying the performance obligation. In those circumstances, the entity shall recognize revenue only to the extent of the costs incurred until such time that it can reasonably measure the outcome of the performance obligation or until the performance obligation becomes onerous.

Measurement of revenue

49. **When (or as) a performance obligation is satisfied, an entity shall recognize as revenue the amount of the transaction price allocated to that performance obligation. If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue an entity recognizes to date shall not exceed the amount to which the entity is reasonably assured to be entitled.**

Determining the transaction price

50. An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, sales taxes). The transaction price does not include the effects of the customer's credit risk as discussed in paragraphs 68 and 69.
51. For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed, or modified.

52. When determining the transaction price, an entity shall consider the effects of all of the following:
- (a) Variable consideration
 - (b) The time value of money
 - (c) Noncash consideration
 - (d) Consideration payable to a customer.

Variable consideration (see paragraphs IG2–IG9)

53. The promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions, or other similar items.
54. If the promised amount of consideration in a contract is variable, an entity shall estimate the total amount to which the entity will be entitled in exchange for transferring the promised goods or services to a customer. An entity shall update the estimated transaction price at each reporting date to represent faithfully the circumstances present at the reporting date and the changes in circumstances during the reporting period. An entity shall account for changes in the transaction price in accordance with paragraphs 77–80.
55. To estimate the transaction price, an entity shall use either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:
- (a) The expected value—The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the transaction price if an entity has a large number of contracts with similar characteristics.
 - (b) The most likely amount—The most likely amount is the single most likely amount in a range of possible consideration amounts (that is, the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the transaction price if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).
56. When estimating the transaction price, an entity shall apply one method consistently throughout the contract. In addition, an entity shall consider all the information (historical, current, and forecasted) that is reasonably available to the entity and shall identify a reasonable number of possible consideration amounts. The information that an entity uses to determine the transaction price typically would be similar to the information that management of the entity uses during the bid and proposal process and in establishing prices for promised goods or services.

57. If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognize as a refund liability the amount of consideration that the entity reasonably expects to refund to the customer. The refund liability (and corresponding change in the transaction price) shall be updated at each reporting period for changes in circumstances. To account for a refund liability relating to a sale with a right of return, an entity shall apply the proposed guidance in paragraphs IG2–IG9.

The time value of money (see paragraph IG66)

58. In determining the transaction price, an entity shall adjust the promised amount of consideration to reflect the time value of money if the contract has a financing component that is significant to the contract. The objective when adjusting the promised amount of consideration to reflect the time value of money is for an entity to recognize revenue at an amount that reflects what the cash selling price would have been if the customer had paid cash for the promised goods or services at the point that they are transferred to the customer. If the promised amount of consideration differs from the cash selling price of the promised goods or services, then the contract also has a financing component (that is, interest either to or from the customer) that may be significant to the contract.
59. In assessing whether a financing component is significant to a contract, an entity shall consider various factors including, but not limited to, the following:
- (a) 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
 - (b) Whether the amount of consideration would differ substantially if the customer paid in cash promptly in accordance with typical credit terms in the industry and jurisdiction
 - (c) The interest rate in the contract and prevailing interest rates in the relevant market.
60. As a practical expedient, an entity need not adjust the promised amount of consideration to reflect the time value of money if the entity expects at contract inception that the period between payment by the customer of all or substantially all of the promised consideration and the transfer of the promised goods or services to the customer will be one year or less.
61. To adjust the promised amount of consideration to reflect the time value of money, an entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception. That rate would reflect the credit characteristics of the

party receiving financing in the contract as well as any collateral or security provided by the customer or the entity, which might include assets transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the cash selling price of the good or service. After contract inception, an entity shall not update the discount rate for changes in circumstances or interest rates.

62. An entity shall present the effects of financing separately from revenue (as interest expense or interest income) in the statement of comprehensive income.

Noncash consideration

63. To determine the transaction price for contracts in which the customer promises consideration in a form other than cash, an entity shall measure the noncash consideration (or promise of noncash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the noncash consideration, it shall measure the consideration indirectly by reference to the standalone selling price of the goods or services promised to the customer (or class of customer) in exchange for the consideration.
64. If a customer contributes goods or services (for example, materials, equipment, or labor) to facilitate an entity's fulfillment of the contract, the entity shall assess whether it obtains control of those contributed goods or services. If so, the entity shall account for the contributed goods or services as noncash consideration received from the customer.

Consideration payable to a customer (see paragraph IG67)

65. Consideration payable to a customer includes amounts that an entity pays, or expects to pay, to a customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash, credit, or other items that the customer can apply against amounts owed to the entity. An entity shall account for consideration payable to a customer as a reduction of the transaction price and, hence, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 28 and 29) that the customer transfers to the entity.
66. If the consideration payable to a customer is a payment for a distinct good or service from the customer, then the entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers. If the amount of consideration payable to the customer exceeds the fair value of the distinct good or service that

the entity receives from the customer, then the entity shall account for such excess as a reduction of the transaction price. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity shall account for all of the consideration payable to the customer as a reduction of the transaction price.

67. Accordingly, if consideration payable to a customer is a reduction of the transaction price, an entity shall recognize the reduction of revenue when (or as) the later of either of the following occurs:
- (a) The entity recognizes revenue for the transfer of the related goods or services to the customer.
 - (b) The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

Collectibility

68. Collectibility refers to a customer's credit risk—that is, the risk that an entity will be unable to collect from the customer the amount of consideration to which the entity is entitled in accordance with the contract. For an unconditional right to consideration (that is, a receivable), an entity shall account for the receivable in accordance with Topic 310 except as specified in paragraph 69. An entity similarly shall account for the effects of a customer's credit risk on a **contract asset** (see paragraph 106).
69. Upon initial recognition of the receivable, any difference between the measurement of the receivable in accordance with Topic 310 and the corresponding amount of revenue recognized shall be presented in profit or loss as a separate line item adjacent to the revenue line item. If the contract does not have a significant financing component in accordance with paragraph 58, an entity shall present any impairment of the receivable (or change in the measurement of an impairment) in profit or loss as a separate line item adjacent to the revenue line item.

Allocating the transaction price to separate performance obligations (see paragraphs IG68 and IG69)

70. **For a contract that has more than one separate performance obligation, an entity shall allocate the transaction price to each separate performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation.**
71. To allocate an appropriate amount of consideration to each separate performance obligation, an entity shall determine the standalone selling price at contract inception of the good or service underlying each

separate performance obligation and allocate the transaction price on a relative standalone selling price basis. The standalone selling price is the price at which an entity would sell a promised good or service separately to a customer.

72. The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers. A contractually stated price or a list price for a good or service may be (but shall not be presumed to be) the standalone selling price of that good or service.
73. If a standalone selling price is not directly observable, an entity shall estimate it. When estimating a standalone selling price, an entity shall consider all information (including market conditions, entity-specific factors, and information about the customer or class of customer) that is reasonably available to the entity. In addition, an entity shall maximize the use of observable inputs and shall apply estimation methods consistently in similar circumstances. Suitable estimation methods include, but are not limited to, the following:
 - (a) Adjusted market assessment approach—An entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach also might include referring to prices from the entity’s competitors for similar goods or services and adjusting those prices as necessary to reflect the entity’s costs and margins.
 - (b) Expected cost plus a margin approach—An entity could forecast its expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service.
 - (c) Residual approach—If the standalone selling price of a good or service is highly variable or uncertain, then an entity may estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. A selling price is highly variable when an entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. A selling price is uncertain when an entity has not yet established a price for a good or service and the good or service has not previously been sold.
74. If the sum of the standalone selling prices of the promised goods or services in the contract exceeds the transaction price (that is, if a customer receives a discount for purchasing a bundle of goods or services), an entity shall allocate that discount to all separate performance obligations on a relative standalone selling price basis except as specified in paragraphs 75 and 76.

75. An entity shall allocate a discount entirely to one (or some) separate performance obligation(s) in the contract if both of the following criteria are met:
- (a) The entity regularly sells each good or service (or each bundle of goods or services) in the contract on a standalone basis.
 - (b) The observable selling prices from those standalone sales provide evidence of the performance obligation(s) to which the entire discount in the contract belongs.
76. If the transaction price includes an amount of consideration that is contingent on a future event or circumstance (for example, an entity's performance or a specific outcome of the entity's performance), the entity shall allocate that contingent amount (and subsequent changes to the amount) entirely to a distinct good or service if both of the following criteria are met:
- (a) The contingent payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service).
 - (b) Allocating the contingent amount of consideration entirely to the distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract.

Changes in the transaction price

77. After contract inception, the transaction price can change for various reasons, including the resolution of uncertain events or other changes in circumstances that change the amount of consideration to which the entity expects to be entitled in exchange for the promised goods or services.
78. An entity shall allocate to the separate performance obligations in the contract any subsequent changes in the transaction price on the same basis as at contract inception. Amounts allocated to a satisfied performance obligation shall be recognized as revenue, or as a reduction of revenue, in the period in which the transaction price changes.
79. An entity shall allocate a change in the transaction price entirely to one or more distinct goods or services only if the criteria in paragraph 76 are met.
80. An entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.

Constraining the cumulative amount of revenue recognized (see paragraphs IG69–IG71)

81. **If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognizes to date shall not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:**
- (a) **The entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities).**
 - (b) **The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.**
82. Indicators that an entity's experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled include, but are not limited to, the following:
- (a) The amount of consideration is highly susceptible to factors outside the entity's influence. Those factors include volatility in a market, the judgment of third parties, weather conditions, and a high risk of obsolescence of the promised good or service.
 - (b) The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
 - (c) The entity's experience (or other evidence) with similar types of performance obligations is limited.
 - (d) The contract has a large number and broad range of possible consideration amounts.
83. An entity shall use judgment and consider all facts and circumstances when evaluating whether the entity's experience is predictive of the amount of consideration to which it will be entitled. The presence of any one of the indicators in paragraph 82 does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.
84. If an entity is not reasonably assured to be entitled to the amount of the transaction price allocated to satisfied performance obligations, the cumulative amount of revenue recognized as of the reporting date is limited to the amount of the transaction price to which the entity is reasonably assured to be entitled.

85. Notwithstanding the requirements in paragraphs 81–83, if an entity licenses intellectual property (see paragraph IG33) to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer’s subsequent sales of a good or service (for example, a sales-based royalty), the entity is not reasonably assured to be entitled to the additional amount of consideration until the uncertainty is resolved (that is, when the customer’s subsequent sales occur).

Onerous performance obligations

86. **For a performance obligation that an entity satisfies over time (see paragraphs 35 and 36) and that the entity expects at contract inception to satisfy over a period of time greater than one year, an entity shall recognize a liability and a corresponding expense if the performance obligation is onerous.**
87. A performance obligation is onerous if the lowest cost of settling the performance obligation exceeds the amount of the transaction price allocated to that performance obligation. The lowest cost of settling a performance obligation is the lower of the following amounts:
- (a) The costs that relate directly to satisfying the performance obligation by transferring the promised goods or services (those costs are described in paragraph 92)
 - (b) The amount that the entity would pay to exit the performance obligation if the entity is permitted to do so other than by transferring the promised goods or services.
88. An entity initially shall measure the liability for an onerous performance obligation at the amount by which the lowest cost of settling the remaining performance obligation exceeds the amount of the transaction price allocated to that remaining performance obligation. At each reporting date, an entity shall update the measurement of the liability for an onerous performance obligation for changes in circumstances. An entity shall recognize changes in the measurement of that liability as an expense or as a reduction of an expense. When an entity satisfies an onerous performance obligation, the entity shall derecognize the related liability.
89. Before an entity recognizes a liability for an onerous performance obligation, the entity shall apply the requirements in paragraphs 100–103 to test for impairment of an asset recognized from the costs incurred to obtain or fulfill a contract with a customer.

90. A not-for-profit entity shall not recognize a liability for an onerous performance obligation if the purpose of the contract is to provide a social or charitable benefit.

Contract costs

Costs to fulfill a contract (see paragraph IG72)

91. **If the costs incurred in fulfilling a contract with a customer are in the scope of another Topic (for example, Topic 330 on inventory, Topic 360 on property, plant, and equipment, or Topic 985 on software), an entity shall account for those costs in accordance with those other Topics. Otherwise, an entity shall recognize an asset from the costs to fulfill a contract only if those costs meet all of the following criteria:**
- (a) **The costs relate directly to a contract (or a specific anticipated contract).**
 - (b) **The costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future.**
 - (c) **The costs are expected to be recovered.**
92. Costs that relate directly to a contract (or a specific anticipated contract) include the following:
- (a) Direct labor (for example, salaries and wages of employees who provide services directly to the customer)
 - (b) Direct materials (for example, supplies used in providing services to the customer)
 - (c) Allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance, and depreciation of tools and equipment used in fulfilling the contract)
 - (d) Costs that are explicitly chargeable to the customer under the contract
 - (e) Other costs that are incurred only because the entity entered into the contract (for example, payments to subcontractors).

93. An entity shall recognize the following costs as expenses when incurred:
- (a) General and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with the criteria in paragraph 91)
 - (b) Costs of wasted materials, labor, or other resources to fulfill the contract that were not reflected in the price of the contract
 - (c) Costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (that is, costs that relate to past performance)
 - (d) Costs that relate to remaining performance obligations but that the entity cannot distinguish from costs that relate to satisfied performance obligations.

Incremental costs of obtaining a contract

94. **An entity shall recognize as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs, subject to the practical expedient in paragraph 97.**
95. The incremental costs of obtaining a contract are those costs that an entity incurs in its efforts to obtain a contract with a customer and that it would not have incurred if the contract had not been obtained (for example, a sales commission).
96. Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognized as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.
97. As a practical expedient, an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

Amortization and impairment (see paragraph IG73)

98. An asset recognized in accordance with paragraph 91 or 94 shall be amortized on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under an anticipated contract that the entity can identify specifically (for example, services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved).
99. An entity shall update the amortization to reflect a significant change in the entity's expected pattern of transfer of the goods or services to which

the asset relates. Such a change shall be accounted for as a change in accounting estimate in accordance with Subtopic 250-10.

100. An entity shall recognize an impairment loss in profit or loss to the extent that the carrying amount of an asset recognized in accordance with paragraph 91 or 94 exceeds:
 - (a) The remaining amount of consideration to which an entity expects to be entitled in exchange for the goods or services to which the asset relates, less
 - (b) The costs that relate directly to providing those goods or services (as described in paragraph 92).
101. To determine the amount to which an entity expects to be entitled, an entity shall use the principles for determining the transaction price.
102. Before an entity recognizes an impairment loss for an asset recognized in accordance with paragraph 91 or 94, the entity shall recognize any impairment loss for assets related to the contract that are recognized in accordance with another Topic (for example, Topic 330), except for impairment losses of asset groups recognized in accordance with Topic 360 on property, plant, and equipment, and impairments of goodwill and intangible assets recognized in accordance with Topic 350 on goodwill and other intangibles.
103. An entity shall not recognize a reversal of an impairment loss previously recognized.

Presentation (see paragraph IG74)

104. **When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract liability, a contract asset, or a receivable depending on the relationship between the entity's performance and the customer's payment.**
105. If a customer pays consideration or an amount of consideration is due before an entity performs by transferring a good or service, the entity shall present the contract as a contract liability. A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer.

106. If an entity performs by transferring goods or services to a customer before the customer pays consideration, the entity shall present the contract as either a contract asset or as a receivable depending on the nature of the entity's right to consideration for its performance.
- (a) A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when that right is conditioned on something other than the passage of time (for example, the entity's future performance).
 - (b) A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if nothing other than the passage of time is required before payment of that consideration is due. An entity shall account for a receivable in accordance with Topic 310.
107. This proposed guidance uses the terms **contract asset** and **contract liability** but does not prohibit an entity from using alternative descriptions in the statement of financial position for those items. If an entity uses an alternative description for a contract asset, the entity shall provide sufficient information for a user of the financial statements to distinguish between unconditional rights to consideration (that is, receivables) and conditional rights to consideration (that is, contract assets).
108. An entity shall present a liability for onerous performance obligations (in accordance with paragraph 86) separately from contract assets or contract liabilities.

Disclosure

[Note: As noted in Question 5 in the Summary and Questions for Respondents section, the Board proposes to amend Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial statements.]

109. **The objective of the proposed disclosure requirements is to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. To achieve that objective, an entity shall disclose qualitative and quantitative information about all of the following:**
- (a) **Its contracts with customers (paragraphs 113–123)**
 - (b) **The significant judgments, and changes in the judgments, made in applying the proposed guidance to those contracts (paragraphs 124–127)**

- (c) **Any assets recognized from the costs to obtain or fulfill a contract with a customer in accordance with paragraphs 91 and 94 (paragraphs 128 and 129).**
- 110. An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics.
- 111. Amounts disclosed are for each period for which a statement of comprehensive income is presented and as of each period for which a statement of financial position is presented, as applicable, unless otherwise stated.
- 112. An entity need not disclose information in accordance with this proposed guidance if it has provided the information in accordance with another Topic.

Contracts with customers

- 113. An entity shall disclose information about its contracts with customers, including all of the following:
 - (a) A disaggregation of revenue for the period (paragraphs 114–116)
 - (b) A reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraph 117)
 - (c) Information about the entity's performance obligations (paragraphs 118–121), including additional information about any onerous performance obligations (paragraphs 122 and 123).

Disaggregation of revenue

- 114. An entity shall disaggregate revenue from contracts with customers (excluding amounts presented for customers' credit risk) into the primary categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. To meet the disclosure objective in paragraph 109, an entity may need to use more than one type of category to disaggregate revenue.
- 115. Examples of categories that might be appropriate include, but are not limited to, the following:
 - (a) Type of good or service (for example, major product lines)
 - (b) Geography (for example, country or region)
 - (c) Market or type of customer (for example, government and nongovernment customers)

- (d) Type of contract (for example, fixed-price and time-and-materials contracts)
 - (e) Contract duration (for example, short-term and long-term contracts)
 - (f) Timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time)
 - (g) Sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).
116. A nonpublic entity need not apply the proposals in paragraphs 114 and 115. Rather, a nonpublic entity shall disclose qualitative information about how economic factors (such as type of customer, geographical location of customers, and type of contract) affect the nature, amount, timing, and uncertainty of revenue and cash flows. A nonpublic entity shall disaggregate revenue in accordance with the timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time).

Reconciliation of contract balances (see paragraph IG75)

117. An entity shall disclose in tabular format a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities. The reconciliation shall disclose each of the following, if applicable:
- (a) The amount(s) recognized in the statement of comprehensive income arising from either of the following:
 - (i) Revenue from performance obligations satisfied during the reporting period
 - (ii) Revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods.
 - (b) Cash received
 - (c) Amounts transferred to receivables
 - (d) Noncash consideration received
 - (e) Effects of business combinations
 - (f) Any additional line items that may be needed to understand the change in the contract assets and contract liabilities.

Performance obligations

118. An entity shall disclose information about its performance obligations in contracts with customers, including a description of all of the following:

- (a) When the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered, or upon completion of service)
 - (b) The significant payment terms (for example, when payment typically is due, whether the consideration amount is variable, and whether the contract has a significant financing component)
 - (c) The nature of the goods or services that the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (that is, if the entity is acting as an agent)
 - (d) Obligations for returns, refunds, and other similar obligations
 - (e) Types of warranties and related obligations.
119. For contracts with an original expected duration of more than one year, an entity shall disclose the following information as of the end of the current reporting period:
- (a) The aggregate amount of the transaction price allocated to remaining performance obligations
 - (b) An explanation of when the entity expects to recognize that amount as revenue.
120. An entity may disclose the information in paragraph 119 either on a quantitative basis using the time bands that would be most appropriate for the duration of the remaining performance obligations or by using qualitative information.
121. As a practical expedient, an entity need not disclose the information in paragraph 119 for a performance obligation if the entity recognizes revenue in accordance with paragraph 42.

Onerous performance obligations

122. An entity shall disclose the amount of the liability recognized for onerous performance obligations along with a description of all of the following:
- (a) The nature and amount of the remaining performance obligation(s) in the contract that are onerous for which the liability has been recognized.
 - (b) Why those performance obligations are onerous.
 - (c) When the entity expects to satisfy those performance obligations.
123. An entity shall disclose in tabular format a reconciliation from the opening to the closing balance of the liability recognized for onerous performance obligations. The reconciliation shall include the amounts attributable to each of the following, if applicable:

- (a) Increases in the liability from performance obligations that became onerous during the period
- (b) Reductions of the liability from performance obligations satisfied during the period
- (c) Changes in the measurement of the liability that occurred during the reporting period
- (d) Any additional line items that may be needed to understand the change in the liability recognized.

Significant judgments in the application of the proposed guidance

124. An entity shall disclose the judgments, and changes in the judgments, made in applying this proposed guidance that significantly affect the determination of the amount and timing of revenue from contracts with customers. At a minimum, an entity shall explain the judgments, and changes in the judgments, used in determining both of the following:
- (a) The timing of satisfaction of performance obligations (paragraphs 125 and 126)
 - (b) The transaction price and the amounts allocated to performance obligations (paragraph 127).

Determining the timing of satisfaction of performance obligations

125. For performance obligations that an entity satisfies over time, an entity shall disclose both of the following:
- (a) The methods used to recognize revenue (for example, a description of the output method or input method)
 - (b) An explanation of why such methods are a faithful depiction of the transfer of goods or services.
126. For performance obligations satisfied at a point in time, an entity shall disclose the significant judgments made in evaluating when the customer obtains control of promised goods or services.

Determining the transaction price and the amounts allocated to performance obligations

127. An entity shall disclose information about the methods, inputs, and assumptions used to:
- (a) Determine the transaction price.
 - (b) Estimate standalone selling prices of promised goods or services.

- (c) Measure obligations for returns, refunds, and other similar obligations.
- (d) Measure the amount of the liability recognized for onerous performance obligations.

Assets recognized from the costs to obtain or fulfill a contract with a customer

128. An entity shall disclose a reconciliation of the opening and closing balances of assets recognized from the costs incurred to obtain or fulfill a contract with a customer (in accordance with paragraphs 91 and 94), by main category of asset (for example, costs to obtain contracts with customers, precontract costs, and setup costs). The reconciliation shall include amounts related to each of the following, if applicable:
- (a) Additions
 - (b) Amortization
 - (c) Impairment losses
 - (d) [This subparagraph in the IASB's Exposure Draft is not used in the FASB's version of the proposed guidance.]
 - (e) Any additional line items that may be needed to understand the change in the reporting period.
129. An entity shall describe the method it uses to determine the amortization for each reporting period.

Nonpublic entity disclosure

130. A nonpublic entity may elect not to provide any of the following disclosures:
- (a) A reconciliation of contract balances (paragraph 117)
 - (b) The amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (paragraph 119)
 - (c) A reconciliation of liability balances recognized from onerous performance obligations (paragraph 123)
 - (d) A reconciliation of asset balances recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128)
 - (e) An explanation of the judgments, and changes in judgments, used in determining the timing of satisfaction of performance obligations (paragraphs 125 and 126) and in determining the transaction price and allocating it to performance obligations (paragraph 127).

Effective date and transition

131. An entity shall apply this proposed guidance for annual reporting periods beginning on or after XXX, XX, 201X. (The Boards have not yet decided on the effective date of this proposed guidance. However, the Boards have decided that the standard would not be effective sooner than for annual reporting periods beginning on or after January 1, 2015. The effective date for nonpublic entities will be a minimum of one year after the effective date for public entities.) Earlier application is not permitted.
132. An entity shall apply this proposed guidance retrospectively by applying the requirements on accounting changes in paragraphs 250-10-45-5 through 45-10, subject to the expedients specified in paragraph 133. In the period of adoption, an entity shall provide the disclosures required in paragraphs 250-10-50-1 through 50-3.
133. An entity may use one or more of the following practical expedients when applying this proposed guidance. For the purposes of the expedients, the date of initial application is the start of the reporting period in which an entity first applies the proposed guidance.
 - (a) For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.
 - (b) For contracts completed before the date of initial application and that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.
 - (c) An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognized previously for that contract in accordance with the requirements that were effective before the date of initial application. If an entity recognizes an onerous contract liability at the date of initial application, the entity shall recognize a corresponding adjustment to the opening balance of retained earnings for that period.
 - (d) For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (as specified in paragraph 119).
134. For any of the practical expedients in paragraph 133 that an entity uses, the entity shall apply that expedient consistently to all reporting periods presented. In addition, the entity shall disclose the following information:

- (a) The expedients that have been used
- (b) To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

Proposed Implementation Guidance and Illustrations

Implementation guidance

- IG1. The following implementation guidance is an integral part of the proposed guidance.
- (a) Sale with a right of return (paragraphs IG2–IG9)
 - (b) Warranties (paragraphs IG10–IG15)
 - (c) Principal versus agent considerations (paragraphs IG16–IG19)
 - (d) Customer options for additional goods or services (paragraphs IG20–IG24)
 - (e) Customers' unexercised rights (paragraphs IG25–IG28)
 - (f) Nonrefundable upfront fees (paragraphs IG29–IG32)
 - (g) Licensing and rights to use (paragraphs IG33–IG37)
 - (h) Repurchase agreements (paragraphs IG38–IG48)
 - (i) Consignment arrangements (paragraphs IG49 and IG50)
 - (j) Bill-and-hold arrangements (paragraphs IG51–IG54)
 - (k) Customer acceptance (paragraphs IG55–IG58).

Sale with a right of return (see paragraphs 53–57 and paragraph IG76)

- IG2. In some contracts, an entity transfers control of a product to a customer and also grants the customer the right to return the product for various reasons (such as dissatisfaction with the product) and receive any combination of the following:
- (a) A full or partial refund of any consideration paid
 - (b) A credit that can be applied against amounts owed, or that will be owed, to the entity
 - (c) Another product in exchange.
- IG3. To account for the transfer of products with a right of return (and for some services that are provided subject to a refund), an entity should recognize all of the following:
- (a) Revenue for the transferred products in the amount of consideration to which the entity is reasonably assured to be entitled (considering the products expected to be returned)
 - (b) A refund liability

- (c) An asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability.
- IG4. An entity's promise to stand ready to accept a returned product during the return period should not be accounted for as a separate performance obligation in addition to the obligation to provide a refund.
- IG5. An entity should apply the proposed guidance in paragraphs 81–83 to determine the amount of consideration to which the entity is reasonably assured to be entitled (considering the products expected to be returned). For any amounts to which an entity is not reasonably assured to be entitled, the entity should not recognize revenue when it transfers products to customers but should recognize any consideration received as a refund liability. Subsequently, the entity should update its assessment of amounts to which the entity is reasonably assured to be entitled in exchange for the transferred products and should recognize corresponding adjustments to the amount of revenue recognized.
- IG6. An entity should update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds. An entity should recognize corresponding adjustments as revenue (or reductions of revenue).
- IG7. An asset recognized for an entity's right to recover products from a customer on settling a refund liability initially should be measured by reference to the former carrying amount of the inventory less any expected costs to recover those products (including potential decreases in the value to the entity of returned products). Subsequently, an entity should update the measurement of the asset to correspond with changes in the measurement of the refund liability. An entity should present the asset separately from the refund liability.
- IG8. Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one color or size for another) are not considered returns for the purposes of applying the proposed guidance.
- IG9. Contracts in which a customer may return a defective product in exchange for a functioning product should be evaluated in accordance with the guidance on warranties in paragraphs IG10–IG15.

Warranties (see paragraph IG77)

- IG10. It is common for an entity to provide (in accordance with the contract, the entity's customary business practices, or the law) a warranty in connection with the sale of a product (whether a good or service). The nature of a warranty can vary significantly across industries and

contracts. Some warranties provide a customer with assurance that the related product complies with agreed-upon specifications. Other warranties provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.

- IG11. If a customer has the option to purchase a warranty separately (for example, because the warranty is priced or negotiated separately), an entity should account for the promised warranty as a separate performance obligation because the entity promises to provide a service to the customer in addition to the product. Hence, the entity should allocate a portion of the transaction price to the performance obligation for the service in accordance with paragraphs 70–80.
- IG12. If a customer does not have the option to purchase a warranty separately, the entity should account for the warranty in accordance with the guidance on product warranties in Subtopic 460-10 unless the promised warranty, or a part of the promised warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications.
- IG13. In assessing whether a warranty provides a customer with a service in addition to the assurance that the product complies with agreed-upon specifications, an entity should consider factors such as:
- (a) Whether the warranty is required by law—If the entity is required by law to provide a warranty, the existence of that law indicates that the warranty is not a performance obligation, because such requirements typically exist to protect customers from the risk of purchasing defective products.
 - (b) The length of the warranty coverage period—The longer the coverage period, the more likely that the warranty is a performance obligation because it is more likely to provide a service in addition to the assurance that the product complies with agreed-upon specifications.
 - (c) The nature of the tasks that the entity promises to perform—If it is necessary for an entity to perform specified tasks to provide the assurance that a product complies with agreed-upon specifications (for example, a return shipping service for a defective product), then those tasks likely do not give rise to a performance obligation.
- IG14. If a warranty, or a part of a warranty, provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications, that promised service is a separate performance obligation. Hence, an entity should allocate the transaction price to the product and the service. If an entity promises both an assurance and a service-type warranty but cannot reasonably account

for them separately, the entity should account for both of the warranties together as a single performance obligation.

- IG15. A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark, or other infringement by the entity's products does not give rise to a performance obligation. The entity should account for such obligations in accordance with the requirements on loss contingencies in Subtopic 450-20.

Principal versus agent considerations

- IG16. When other parties are involved in providing goods or services to an entity's customer, the entity should determine whether its performance obligation is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for another party to provide those goods or services (that is, the entity is an agent). That determination affects whether the entity recognizes revenue in the gross amount of consideration to which the entity is entitled in exchange for those goods or services (if a principal) or in the amount of any fee or commission received in exchange for arranging for the other party to provide its goods or services (if an agent). An entity's fee or commission might be the net amount of consideration that the entity retains after paying other parties for providing their goods or services to the customer.
- IG17. If an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation is to provide the goods or services itself. Hence, the entity is acting as a principal and should recognize revenue in the gross amount to which it is entitled. If an entity obtains legal title of a product only momentarily before legal title is transferred to the customer, the entity is not necessarily acting as a principal.

- IG18. Indicators that the entity's performance obligation is to arrange for the provision of goods or services by another party (that is, that the entity is an agent and should recognize revenue in the net amount) include the following:
- (a) The other party is primarily responsible for fulfilling the contract.
 - (b) The entity does not have inventory risk before or after the customer order, during shipping, or on return.
 - (c) The entity does not have latitude in establishing prices for the other party's goods or services and, hence, the benefit that the entity can receive from those goods or services is constrained.
 - (d) The entity's consideration is in the form of a commission.
 - (e) The entity does not have customer credit risk for the amount receivable in exchange for the other party's goods or services.
- IG19. If another party assumes an entity's performance obligation so that the entity is no longer obliged to provide the promised good or service to the customer (that is, the entity is no longer acting as the principal), the entity should not recognize revenue for that performance obligation. Instead, the entity should evaluate whether to recognize revenue for satisfying a performance obligation to obtain a contract for the other party (that is, whether the entity is acting as an agent).

Customer options for additional goods or services (see paragraphs 70–76 and IG78–IG80)

- IG20. Customer options to acquire additional goods or services for free or at a discount come in many forms, including sales incentives, customer award credits (or points), contract renewal options, or other discounts on future goods or services.
- IG21. If in a contract with more than one performance obligation an entity grants a customer the option to acquire additional goods or services, that option gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that it would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires.
- IG22. If a customer has the option to acquire an additional good or service at a price that would reflect the standalone selling price for that good or service, that option does not provide the customer with a material right even if the option can be exercised only because of entering into a

previous contract. In those cases, the entity has merely made a marketing offer that it should account for in accordance with the proposed revenue guidance only when the customer exercises the option to purchase the additional goods or services.

- IG23. Paragraph 71 requires an entity to allocate the transaction price to separate performance obligations on a relative standalone selling price basis. If the standalone selling price for a customer's option to acquire additional goods or services is not directly observable, an entity should estimate it. That estimate should reflect the discount the customer would obtain when exercising the option, adjusted for both of the following:
- (a) Any discount that the customer could receive without exercising the option
 - (b) The likelihood that the option will be exercised.
- IG24. If a customer has a material right to acquire future goods or services and those goods or services are similar to the original goods or services in the contract and are provided in accordance with the terms of the original contract, then an entity may, as a practical alternative to estimating the standalone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. Typically, those types of options are for contract renewals.

Customers' unexercised rights (breakage)

- IG25. In accordance with paragraph 105, upon receipt of a prepayment from a customer, an entity should recognize a contract liability for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. An entity should derecognize that contract liability (and recognize revenue) when it transfers those goods or services and, hence, satisfies its performance obligation.
- IG26. A customer's nonrefundable prepayment to an entity gives the customer a right to receive a good or service in the future (and obliges the entity to stand ready to transfer a good or service). However, customers may not exercise all of their contractual rights. Those unexercised rights often are referred to as breakage.
- IG27. If an entity is reasonably assured of a breakage amount in a contract liability, the entity should recognize the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. If an entity is not reasonably assured of a breakage amount, the entity should recognize the expected breakage amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote. To determine whether an entity is reasonably assured of a

breakage amount, the entity should consider the proposed guidance in paragraphs 81–83.

- IG28. An entity should recognize a liability (and not revenue) for any customer balances for which the entity may be required to remit the funds to a government entity in accordance with applicable unclaimed property laws.

Nonrefundable upfront fees (and some related costs)

- IG29. In some contracts, an entity charges a customer a nonrefundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in some services contracts, and initial fees in some supply contracts.
- IG30. To identify performance obligations in such contracts, an entity should assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a nonrefundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfill the contract, that activity does not result in the transfer of a promised good or service to the customer (see paragraph 25). Instead, the upfront fee is an advance payment for future goods or services and, hence, would be recognized as revenue when those future goods or services are provided. The revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as specified in paragraph IG21.
- IG31. If the nonrefundable upfront fee relates to a performance obligation, the entity should evaluate whether to account for that performance obligation separately in accordance with paragraphs 23–30.
- IG32. An entity may charge a nonrefundable fee in part as compensation for costs incurred in setting up a contract (or other administrative tasks as specified in paragraph 25). If those setup activities do not satisfy a performance obligation, the entity should disregard those activities (and related costs) when measuring progress in accordance with paragraph 45. That is because the costs of setup activities do not depict the transfer of services to the customer. The entity should evaluate whether costs incurred in setting up a contract have resulted in an asset that should be recognized in accordance with paragraph 91.

Licensing and rights to use (see paragraph IG81)

- IG33. Licensing refers to an entity's granting a customer the right to use, but not own, intellectual property of the entity. Rights to use can vary by

time, geography, or form of distribution. Examples of intellectual property include all of the following:

- (a) Software and technology
- (b) Motion pictures, music, and other forms of media and entertainment
- (c) Franchises
- (d) Patents, trademarks, and copyrights.

- IG34. If an entity grants to a customer a license or other rights to use intellectual property of the entity, those promised rights give rise to a performance obligation that the entity satisfies at the point in time when the customer obtains control of the rights. Control of rights to use intellectual property cannot be transferred before the beginning of the period during which the customer can use and benefit from the licensed intellectual property. For example, if a software license period begins before the customer obtains an access code that enables the customer to use the software, an entity should not recognize revenue before the entity provides the access code.
- IG35. To determine the amount of revenue recognized for transferring a license to a customer, the entity should apply the proposed guidance on determining and allocating the transaction price (including paragraph 85 on constraining the amount of revenue recognized to amounts that are reasonably assured).
- IG36. If an entity has other performance obligations in the contract, the entity should apply the criteria in paragraphs 23–30 to determine whether the promised rights are a separate performance obligation or whether the performance obligation for the rights should be combined with those other performance obligations in the contract. For example, if an entity grants a license that is not distinct because the customer cannot benefit from the license without an additional service that the entity promises to provide, the entity should account for the combined license and service as a single performance obligation satisfied over time.
- IG37. If an entity has a patent to intellectual property that it licenses to customers, the entity may represent and guarantee to its customers that it has a valid patent and that it will defend and maintain that patent. That promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer. Defending a patent protects the value of the entity's intellectual property assets.

Repurchase agreements (see paragraph 37)

- IG38. A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.
- IG39. Repurchase agreements generally come in three forms:
- (a) An entity's unconditional obligation to repurchase the asset (a forward)
 - (b) An entity's unconditional right to repurchase the asset (a call option)
 - (c) An entity's unconditional obligation to repurchase the asset at the customer's request (a put option).

A forward or a call option

- IG40. If an entity has an unconditional obligation or unconditional right to repurchase the asset (a forward or a call option), the customer does not obtain control of the asset because the customer is limited in its ability to direct the use of and obtain substantially all of the remaining benefits from the asset (even though the customer may have physical possession of the asset). Consequently, the entity should account for the contract as either of the following:
- (a) A lease in accordance with Topic 840, if the entity can repurchase the asset for an amount that is less than the original selling price of the asset
 - (b) A financing arrangement in accordance with paragraph IG42, if the entity can repurchase the asset for an amount that is equal to or more than the original selling price of the asset.
- IG41. When comparing the repurchase price with the selling price, an entity should consider the effects of the time value of money.
- IG42. If the repurchase agreement is a financing arrangement, the entity should continue to recognize the asset and also recognize a financial liability for any consideration received from the customer. The entity should recognize the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, holding costs (for example, insurance). If the option lapses unexercised, an entity should derecognize the liability and recognize revenue.

A put option

- IG43. If an entity has an unconditional obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity should consider at contract inception whether a customer has a significant economic incentive to exercise that right. The customer's exercising of that right results in the customer effectively paying the entity consideration for the right to use a specified asset for a period of time. Hence, if the customer has a significant economic incentive to exercise that right, the entity should account for the agreement as a lease in accordance with Topic 840.
- IG44. To determine whether a customer has a significant economic incentive to exercise its right, an entity should consider various factors, including the relationship of the repurchase price to the expected market value of the asset at the date of repurchase and the amount of time until the right expires. If the repurchase price is expected to significantly exceed the market value of the asset, the customer has an economic incentive to exercise the put option.
- IG45. If the customer does not have a significant economic incentive to exercise its right, the entity should account for the agreement similar to the sale of a product with a right of return as discussed in paragraphs IG2–IG9.
- IG46. If the repurchase price of the asset exceeds the original selling price and is more than the expected market value of the asset, the contract is in effect a financing arrangement. Hence, an entity should:
- (a) Continue to recognize the asset.
 - (b) Recognize a liability that initially should be measured at the amount of the original selling price of the asset.
- IG47. When comparing the repurchase price with the selling price, an entity should consider the effects of the time value of money.
- IG48. If the option lapses unexercised, an entity should derecognize the liability and recognize revenue.

Consignment arrangements (see paragraph 37)

- IG49. When an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, the entity should evaluate whether that other party has obtained control of the product at that point in time.
- IG50. Inventory on consignment typically is controlled by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires. Until that point, the entity

typically is able to require the return of the products or transfer them to another dealer. Moreover, the dealer typically does not have an unconditional obligation to pay for the products (although it might be required to pay a deposit). Accordingly, in those circumstances, the entity would not recognize revenue upon delivery of the products to the dealer.

Bill-and-hold arrangements (see paragraph 37)

- IG51. A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. A customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules.
- IG52. An entity should determine when it has satisfied its performance obligation to transfer a product by evaluating when the customer obtains control of that product. For some contracts, control is transferred either when the product is delivered to the customer's site or when the product is shipped, depending on the terms of the contract (including delivery and shipping terms). However, for some contracts, a customer may obtain control of a product even though that product remains in the physical possession of the entity. In such cases, the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from the product even though it has decided not to exercise its right to take physical possession of that product. Consequently, the entity does not control the product. Instead, the entity provides custodial services to the customer over the customer's asset.
- IG53. For a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria should be met:
- (a) The reason for the bill-and-hold arrangement must be substantive.
 - (b) The product must be identified separately as belonging to the customer.
 - (c) The product currently must be ready for physical transfer to the customer.
 - (d) The entity cannot have the ability to use the product or to direct it to another customer.
- IG54. If an entity recognizes revenue for the sale of a product on a bill-and-hold basis, the entity should consider whether it has remaining separate performance obligations (for example, for custodial services) in accordance with paragraphs 23–30 to which the entity should allocate a portion of the transaction price in accordance with paragraphs 70–80.

Customer acceptance (see paragraph 37)

- IG55. In accordance with paragraph 37(e), a customer's acceptance of an asset indicates that the customer has obtained control of the asset. Customer acceptance clauses allow the customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications. An entity should consider such clauses when evaluating when a customer obtains control of a good or service.
- IG56. If an entity can objectively determine that control of a good or service has been transferred to the customer in accordance with the agreed-upon specifications in the contract, then customer acceptance is a formality that would not affect an entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving confirmation of the customer's acceptance. The entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed-upon specifications in the contract. If revenue is recognized before customer acceptance, the entity still must consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.
- IG57. However, if an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed-upon specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because the entity cannot determine that the customer has the ability to direct the use of and obtain substantially all of the remaining benefits from the good or service.
- IG58. If an entity delivers products to a customer for trial or evaluation purposes and the customer is not committed to pay any consideration until the trial period lapses, control of the product is not transferred to the customer until either the customer accepts the product or the trial period lapses.

Illustrations

- IG59. The following Examples are an integral part of the proposed guidance and are intended to illustrate how an entity might apply some of the proposed guidance to particular aspects of a contract with a customer on the basis of the limited facts presented. Additional facts most likely

would be required to fully evaluate the contract. The evaluations following each Example are not intended to represent the only manner in which the proposed guidance could be applied.

IG60. The Examples correspond with the following topics in the proposed guidance:

- (a) Contract modifications (paragraph IG61)
- (b) Identifying separate performance obligations (paragraph IG62)
- (c) Satisfaction of performance obligations (paragraphs IG63 and IG64)
- (d) Measuring progress toward complete satisfaction of a performance obligation (paragraph IG65)
- (e) The time value of money (paragraph IG66)
- (f) Consideration payable to a customer (paragraph IG67)
- (g) Allocating the transaction price to separate performance obligations (paragraphs IG68 and IG69)
- (h) Constraining the cumulative amount of revenue recognized (paragraphs IG70 and IG71)
- (i) Costs to obtain and fulfill a contract (paragraph IG72)
- (j) Amortization of an asset recognized from costs to fulfill a contract (paragraph IG73)
- (k) Presentation (paragraph IG74)
- (l) Reconciliation of contract balances (paragraph IG75)
- (m) Sale with a right of return (paragraph IG76)
- (n) Warranties (paragraph IG77)
- (o) Customer options for additional goods or services (paragraphs IG78–IG80)
- (p) Licensing (paragraph IG81).

Contract modifications (paragraphs 18–22)

IG61. The following Examples illustrate the proposed guidance in paragraphs 18–22 on contract modifications.

Example 1—Separate contract for goods

An entity promises to sell 120 products to a customer for \$12,000 (\$100 per product). The products are transferred to the customer at various points in time over a six-month period. The contract is modified after 60 products have been transferred, and the entity promises to deliver an additional 30 products for an additional \$2,850 or \$95 per product. The pricing for the additional products reflects the standalone selling price of the products at the time of the contract modification. In addition, the additional products are distinct from the original products because the entity regularly sells the products separately. Therefore, the contract modification for the additional 30 products is, in effect, a new and separate contract for future products that does not affect the accounting for the existing contract.

If the pricing for the additional products did not reflect the standalone selling price of the additional products, the entity would allocate the modified transaction price (less the amounts allocated to products transferred at or before the date of the modification) to all remaining products to be transferred. Consequently, the amount recognized as revenue for each of the remaining products would be a blended price of \$98.33 $\{[(\$100 \times 60 \text{ products not yet transferred under original contract}) + (\$95 \times 30 \text{ products to be transferred under the contract modification})] \div 90 \text{ remaining products}\}$ per product.

Example 2—Modification of a services contract

An entity enters into a three-year services contract. The customer promises to pay \$100,000 at the beginning of each year. The standalone selling price of the services at contract inception is \$100,000 per year. At the end of the second year, the contract is modified and the fee for the third year of services is reduced to \$80,000. In addition, the customer agrees to pay an additional \$200,000 to extend the contract for 3 additional years (that is, 4 years remain after the modification). The standalone selling price of the services at the beginning of the third year is \$80,000 per year. The entity's standalone selling price multiplied by the number of years is deemed to be an appropriate estimate of the standalone selling price of the multi-year contract (that is, the standalone selling price is 4 years \times \$80,000 per year = \$320,000).

Example 2—Modification of a services contract (continued)

At the date of modification, the entity evaluates the remaining services to be provided and concludes that they are distinct in accordance with paragraphs 28 and 29. However, the amount of remaining consideration to be paid (\$280,000) does not reflect the standalone selling price of the services to be provided (\$320,000). Hence, the entity would reallocate the remaining consideration of \$280,000 to the remaining services to be provided and would recognize revenue of \$70,000 per year ($\$280,000 \div 4$ years) as the services are provided.

Example 3—Modification of an existing performance obligation

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

| | |
|-----------------------|-------------------|
| Transaction price | \$1,000,000 |
| Expected costs | <u>800,000</u> |
| Expected profit (20%) | <u>\$ 200,000</u> |

By the end of the first year, the entity has satisfied 50 percent of its performance obligation on the basis of costs incurred (\$400,000) relative to total expected costs (\$800,000). Hence, the cumulative revenue and costs recognized for the first year are as follows:

| | |
|--------------|------------------|
| Revenue | \$500,000 |
| Costs | <u>400,000</u> |
| Gross profit | <u>\$100,000</u> |

Example 3—Modification of an existing performance obligation (continued)

At the beginning of the second year, the parties to the contract agree to change the floor plan of the house. As a result, the contract revenue and expected costs increase by \$100,000 and \$75,000, respectively. The entity concludes that the remaining goods and services to be provided under the modified contract are not distinct in accordance with paragraphs 28 and 29 because the entity provides a significant service of integrating the highly interrelated goods and services into the combined item (the house) for which the customer has contracted. In addition, providing the house requires the entity to significantly modify the promised goods and services.

Consequently, the entity accounts for the contract modification as if it were part of the original contract. The entity updates its measure of progress and estimates that it has satisfied 45.7 percent of its performance obligation ($\$400,000$ actual costs incurred \div $\$875,000$ total expected costs). In addition, the entity would recognize additional revenue of $\$2,700$ (45.7% complete \times $\$1,100,000$ modified transaction price $-$ $\$500,000$ revenue recognized to date).

Identifying separate performance obligations (paragraphs 23–30)

- IG62. The following Examples illustrate the proposed guidance in paragraphs 27–29 on determining whether to account for a bundle of goods or services as one performance obligation.

Example 4—Significant customization of software

An entity licenses customer relationship management software to a customer. In addition, the entity promises to provide consulting services to significantly customize the software to the customer's information technology environment for total consideration of \$600,000.

Example 4—Significant customization of software (continued)

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

Example 5—Construction

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

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

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

Satisfaction of performance obligations (paragraphs 31–37)

- IG63. The following Example illustrates the proposed guidance on identifying separate performance obligations and determining when a performance

obligation is satisfied if the entity retains the risk of loss during shipment of a product.

Example 6—Shipment of a product with risk of loss

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

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

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

- IG64. The following Example illustrates the proposed guidance in paragraphs 35 and 36 on determining whether an asset has an alternative use to an entity and if one of the criteria is met for satisfaction of a performance obligation over time.

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

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

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

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

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

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

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

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

Example 8—Uninstalled materials

An entity enters into a contract with a customer to construct a facility for \$140 million over 2 years. The contract also requires the entity to procure specialized equipment from a third party and integrate that equipment into the facility. The entity expects to transfer control of the specialized equipment approximately six months from when the project begins. The installation and integration of the equipment continue throughout the contract. The contract is a single performance obligation in accordance with paragraph 29 because all of the promised goods or services in the contract are highly interrelated and the entity also provides a significant service of integrating those goods or services into the single facility for which the customer has contracted. In addition, the entity significantly modifies the bundle of goods and services to fulfill the contract. The entity measures progress toward complete satisfaction of the performance obligation on the basis of costs incurred relative to total costs expected to be incurred.

At contract inception, the entity expects the following:

| | | |
|-----------------------------------|-------------------|----------------------|
| Transaction price | | \$140,000,000 |
| Cost of the specialized equipment | 40,000,000 | |
| Other costs | <u>80,000,000</u> | |
| Total expected costs | | <u>\$120,000,000</u> |

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

Example 8—Uninstalled materials (continued)

During the first 6 months, the entity incurs \$20,000,000 of costs relative to the total \$80,000,000 of expected costs (excluding the \$40,000,000 cost of the specialized equipment). Hence, the entity estimates that the performance obligation is 25 percent complete ($\$20,000,000 \div \$80,000,000$) and recognizes revenue of \$25,000,000 [$25\% \times (\$140,000,000 \text{ total transaction price} - \$40,000,000 \text{ revenue for the specialized equipment})$].

Upon transfer of control of the specialized equipment, the entity recognizes revenue and costs of \$40,000,000.

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

The time value of money (paragraphs 58–62)

IG66. The following Example illustrates how an entity would apply the proposed guidance in paragraphs 58–62 to account for the effects of the time value of money.

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

An entity enters into a contract to sell Product A and Product B for an upfront cash payment of \$150,000. Product A will be delivered in two years and Product B will be delivered in five years. The entity allocates the \$150,000 to Products A and B on a relative standalone selling price basis as follows:

| | <u>Standalone Selling Prices</u> | <u>Percent Allocated</u> | <u>Allocated Amounts</u> |
|-----------|--------------------------------------|------------------------------|------------------------------|
| Product A | \$ 40,000 | 25% | \$ 37,500 |
| Product B | <u>120,000</u> | 75% | <u>112,500</u> |
| Total | <u>\$160,000</u> | | <u>\$150,000</u> |

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

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

- (a) Recognize the contract liability for the \$150,000 payment at contract inception.

| | | | |
|------|--------------------|-----------|-----------|
| Cash | | \$150,000 | |
| | Contract liability | | \$150,000 |

- (b) During the 2 years from contract inception until the transfer of Product A, recognize the interest expense on \$150,000 at 6 percent for 2 years.

| | | | |
|------------------|--------------------|-----------------------|----------|
| Interest expense | | \$18,540 ^a | |
| | Contract liability | | \$18,540 |

^a\$18,540 = \$150,000 contract liability × (1.06² – 1).

Example 9—Time value of money in a multiple-element arrangement (continued)

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

| | | |
|--------------------|-----------------------|----------|
| Contract liability | \$42,135 ^b | |
| Revenue | | \$42,135 |

^b\$42,135 = \$37,500 initial allocation to Product A + \$4,635, which is Product A's portion (25 percent) of the \$18,540 interest for the first 2 years of the contract.

- (d) Recognize the interest expense for 3 years on the remaining contract liability of \$126,405.^c

| | | |
|--------------------|-----------------------|----------|
| Interest expense | \$24,145 ^d | |
| Contract liability | | \$24,145 |

^c\$126,405 = \$150,000 initial contract liability + \$18,540 interest for 2 years – \$42,135 derecognized from the transfer of Product A.

^d\$24,145 = \$126,405 contract liability balance after 2 years × (1.06³ – 1).

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

| | | |
|--------------------|------------------------|-----------|
| Contract liability | \$150,550 ^e | |
| Revenue | | \$150,550 |

^e\$150,550 = \$126,405 contract liability balance after 2 years + \$24,145 interest for 3 years.

Consideration payable to a customer (paragraphs 65–67)

IG67. The following Example illustrates the proposed guidance in paragraph 67 on consideration payable to the customer.

Example 10—Volume discount incentive

An entity enters into a contract with a customer to sell Product A for \$100 per unit. If the customer purchases more than 1,000 units of Product A in a calendar year, the price per unit is retroactively reduced to \$90 per unit. The entity's experience is predictive of the amount of consideration to which the entity will be entitled.

For the first quarter ended March 31, the entity sells 90 units of Product A to the customer, and the entity estimates that the customer's purchases will not exceed the 1,000 units threshold required for the volume discount in the calendar year. Hence, the entity recognizes revenue of \$9,000 (90 units × \$100 per unit) for the period ended March 31. The entity is reasonably assured to be entitled to that amount.

In June, the entity's customer acquires another company. As a result, the entity estimates that the customer's purchases will exceed the 1,000 units threshold for the calendar year. For the second quarter ended June 30, the entity sells an additional 500 units of Product A to the customer. Hence, the entity recognizes revenue of \$44,100 for the period ended June 30. That amount equals \$45,000 for the sale of 500 units (500 units × \$90 per unit) less \$900 (90 units × \$10 price reduction) for the reduction of revenue relating to units sold for the quarter ended March 31. The entity is reasonably assured to be entitled to that amount.

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

- IG68. The following Example illustrates the proposed guidance in paragraph 75 on allocating a discount to only one performance obligation in a contract rather than to all separate performance obligations in the contract.

Example 11—Allocating a discount

An entity enters into a contract with a customer to sell Products A, B, and C for a total transaction price of \$36. The entity regularly sells Products A, B, and C on a standalone basis for the following prices:

| | <u>Standalone Selling Prices</u> |
|-----------|---|
| Product A | \$ 9 |
| Product B | 11 |
| Product C | <u>20</u> |
| Total | <u>\$40</u> |

The customer receives a \$4 discount (\$40 sum of standalone selling prices – \$36 transaction price) for buying the bundle of 3 products. Because Products A and B are transferred at the same time, the entity accounts for only two separate performance obligations in accordance with paragraph 30: one for Products A and B combined and another for Product C. The entity regularly sells Products A and B as a bundle for \$16 (that is, at a \$4 discount). Because the entity regularly sells Products A and B together for \$16 and regularly sells Product C for \$20, the entity has observable prices as evidence that the \$4 discount in the contract should be allocated only to Products A and B. Hence, the entity allocates the transaction price of \$36 as follows:

| | <u>Allocated Amounts</u> |
|------------------|-------------------------------------|
| Products A and B | \$ 16 |
| Product C | <u>20</u> |
| Total | <u>\$ 36</u> |

- IG69. The following Example illustrates the proposed guidance in paragraphs 70–76 on allocating the transaction price in a contract with contingent consideration and paragraphs 81–85 on constraining the cumulative amount of revenue when the promised amount of consideration is variable.

Example 12—Multiple performance obligations and contingent consideration

Scenario 1

An entity enters into a contract with a customer for two intellectual property licenses (License A and License B), which are two separate performance obligations. The stated price for License A is a fixed amount of \$800, and for License B the price is 3 percent of the customer's future sales of products that use License B. The entity's estimate of the transaction price is \$1,700 (which includes \$900 of estimated royalties for License B). The estimated standalone selling prices of Licenses A and B are \$800 and \$1,000, respectively.

Applying the criteria in paragraph 76, the entity would allocate the contingent royalty payment of \$900 entirely to License B because that contingent payment relates specifically to an outcome from the performance obligation to transfer License B (that is, the customer's subsequent sales of products that use License B). In addition, allocating the expected royalty amounts of \$900 entirely to License B is consistent with the allocation principle in paragraph 70 when considering the other payment terms and performance obligations in the contract.

The entity transfers License B at inception of the contract and transfers License A one month later. Upon transfer of License B, the entity recognizes as revenue only the amount to which it is reasonably assured to be entitled. Because the expected royalty amount of \$900 varies entirely on the basis of the customer's subsequent sales of products that use License B, the entity is not reasonably assured to receive that amount until the customer's subsequent sales occur (in accordance with paragraph 85). Therefore, the entity would not recognize revenue at the \$900 allocated amount until the customer sells the products that use License B.

When License A is transferred, the entity would recognize as revenue the \$800 allocated to License A.

Example 12—Multiple performance obligations and contingent consideration (continued)

Scenario 2

An entity enters into a contract with a customer for two intellectual property licenses (License A and License B), which are two separate performance obligations. The stated price for License A is \$300, and for License B the price is 5 percent of the customer's future sales of products using License B. The entity's estimate of the transaction price is \$1,800 (which includes \$1,500 of royalties for License B). The estimated standalone selling prices of Licenses A and B are \$800 and \$1,000, respectively.

Applying the criteria in paragraph 76, the entity concludes that even though the contingent payment relates to subsequent sales of License B, allocating that amount entirely to License B would not be consistent with the principle for allocating the transaction price because the contingent payment does not reflect the amount to which the entity expects to be entitled in exchange for License B when considering the other payment terms and performance obligations in the contract. Hence, the entity would allocate the total transaction price of \$1,800 (\$300 fixed payment + \$1,500 contingent payment) to Licenses A and B on a relative standalone selling price basis of \$800 and \$1,000, respectively.

The entity transfers License A at the inception of the contract and transfers License B one month later. Upon transfer of License A, the entity recognizes as revenue only the amount to which it is reasonably assured to be entitled. Because the \$1,500 varies entirely on the basis of the customer's subsequent sales of products that use License B, the entity is not reasonably assured to receive that amount until the customer's subsequent sales occur (in accordance with paragraph 85). Therefore, the amount of revenue recognized for License A is limited to \$300 at the time of transfer of License A to the customer.

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

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

- IG70. The following Example illustrates the proposed guidance in paragraphs 81–85 on constraining cumulative revenue to amounts that are reasonably assured.

Example 13—Management fees

On January 1, an entity enters into a contract with a client to provide asset management services for one year. The entity receives a quarterly management fee based on a percentage of the client's assets under management at the end of each quarter. In addition, the entity receives a performance-based incentive fee of 20 percent of the fund's return in excess of the return of an observable index at the end of the year.

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

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

The entity concludes that it is not reasonably assured to be entitled to the incentive fee until the end of the year. Although the entity has experience with similar contracts, that experience is not predictive of the outcome of the current contract because the amount of consideration is highly susceptible to volatility in the market. In addition, the incentive fee has a large number and high variability of possible consideration amounts.

Example 13—Management fees (continued)

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

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

Example 14—Trailing commission

An entity sells an insurance policy on behalf of an insurance company for a commission of \$100. In addition, the entity will receive an additional commission of \$10 each year for as long as the policyholder does not cancel its policy. After selling the policy, the entity does not have any remaining performance obligations.

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

The entity determines that the transaction price is \$145 (because on average, customers renew for 4.5 years) and allocates that amount to the performance obligation. When the entity satisfies its performance obligation by selling the insurance policy to the customer, it recognizes revenue of \$145 because it determines that it is reasonably assured to be entitled to that amount. The

Example 14—Trailing commission (continued)

entity concludes that its past experience is predictive, even though the total amount of commission that the entity ultimately will receive depends on the actions of a third party (that is, policyholder behavior). As circumstances change, the entity updates its estimate of the transaction price and recognizes revenue (or a reduction of revenue) for those changes in circumstances.

Incremental costs of obtaining a contract and costs to fulfill a contract (paragraphs 91–97)

- IG72. The following Example illustrates the proposed guidance in paragraphs 91–97 on accounting for costs incurred to obtain and fulfill a contract that do not give rise to an asset eligible for recognition in accordance with another Topic (for example, inventory; property, plant, and equipment; or capitalized software).

Example 15—Costs that give rise to an asset

An entity enters into a contract to outsource a customer’s information technology data center for five years. The entity incurs selling commission costs of \$10,000 to obtain the contract. Before providing the services, the entity designs and builds a technology platform that interfaces with the customer’s systems. That platform is not transferred to the customer.

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

The \$10,000 incremental costs of obtaining the contract are recognized as an asset in accordance with paragraph 94. The asset is amortized over the term of the contract.

The initial costs incurred to set up the technology platform are as follows:

| | |
|-------------------------------------|------------------|
| Design services | \$ 40,000 |
| Hardware | 120,000 |
| Software | 90,000 |
| Migration and testing of datacenter | <u>100,000</u> |
| Total costs | <u>\$350,000</u> |

Example 15—Costs that give rise to an asset (continued)

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

- (a) Hardware costs—accounted for in accordance with Topic 360 on property, plant, and equipment
- (b) Software costs—accounted for in accordance with Topic 350
- (c) Costs of the design, migration, and testing of the datacenter—considered for capitalization in accordance with paragraph 91. Any resulting asset would be amortized on a systematic basis over five years as the entity provides the services outsourced by the customer.

Amortization of an asset recognized from costs to fulfill a contract (paragraphs 98–103)

IG73. The following Example illustrates the proposed guidance in paragraph 98 on amortizing an asset recognized from the costs to fulfill a contract when that asset relates to goods or services to be provided under future contracts with the same customer.

Example 16—Amortization

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

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

Example 16—Amortization (continued)

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

Presentation (paragraphs 104–108)

IG74. The following Examples illustrate the proposed presentation guidance in paragraphs 104–106.

Example 17—Contract liability and receivable

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

When the amount of consideration is due on January 31:

| | | |
|--------------------|---------|---------|
| Receivable | \$1,000 | |
| Contract liability | | \$1,000 |

On receiving the cash on March 1:

| | | |
|------------|---------|---------|
| Cash | \$1,000 | |
| Receivable | | \$1,000 |

On satisfying the performance obligation on March 31:

| | | |
|--------------------|---------|---------|
| Contract liability | \$1,000 | |
| Revenue | | \$1,000 |

Example 17—Contract liability and receivable (continued)

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

Example 18—Contract asset and receivable

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

The entity identifies separate performance obligations for Products X and Y and allocates \$400 to Product X and \$600 to Product Y, on the basis of their standalone selling prices.

On satisfying the performance obligation to transfer Product X:

| | | |
|----------------|-------|-------|
| Contract asset | \$400 | |
| Revenue | | \$400 |

On satisfying the performance obligation to transfer Product Y:

| | | |
|----------------|---------|-------|
| Receivable | \$1,000 | |
| Contract asset | | \$400 |
| Revenue | | \$600 |

Reconciliation of contract balances (paragraph 117)

IG75. The following Example illustrates the proposed requirement in paragraph 117 to disclose a reconciliation of contract assets and contract liabilities:

Example 19—Reconciliation of contract assets and contract liabilities

An entity has two main business units: a services business and a retail business. Customers of the services business typically pay a portion of the promised consideration in advance of receiving the services and the remaining amount upon completion of the services. The service contracts do not include a significant financing component. Customers of the retail business typically pay in cash at the time of transfer of the promised goods.

During 20X1, the entity recognized revenue of \$18,500 from contracts with customers (\$1,000 of which was cash sales from the entity's retail business). The entity received \$3,500 payments in advance.

Included in the transaction price of one of the entity's services contracts is a performance bonus that the entity will receive only if it meets a specified milestone by a specified date. The entity includes that performance bonus in the transaction price and recognizes revenue over time using an appropriate method of measuring progress. As of December 31, 20X0, the entity was not reasonably assured to be entitled to the cumulative amount of consideration that was allocated to the entity's past performance at that date. However, during 20X1 the entity became reasonably assured to be entitled to the performance bonus. Consequently, the entity recognized a contract asset and revenue of \$500 for the portion of the bonus relating to the entity's performance in the previous reporting period.

As a result of a business combination on December 31, 20X1, the entity's contract assets increased by \$4,000 and its contract liabilities increased by \$1,900.

Example 19—Reconciliation of contract assets and contract liabilities (continued)

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

Sale with a right of return (paragraphs IG2–IG9)

IG76. The following Example illustrates the proposed guidance in paragraphs IG2–IG9 on accounting for the sale of products with a right of return.

Example 20—Right of return

An entity sells 100 products for \$100 each. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The cost of each product is \$60. To determine the transaction price, the entity decides that the approach that is most predictive of the amount of consideration to which the entity will be entitled is the most likely amount. Using the most likely amount, the entity estimates that three products will be returned. The entity's experience is predictive of the amount of consideration to which the entity will be entitled.

Example 20—Right of return (continued)

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

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

- (a) Revenue of \$9,700 ($\100×97 products expected not to be returned)
- (b) A refund liability for \$300 ($\100 refund \times 3 products expected to be returned)
- (c) An asset of \$180 ($\60×3 products) for its right to recover products from customers on settling the refund liability. Hence, the amount recognized in cost of sales for 97 products is \$5,820 ($\60×97).

Warranties (paragraphs IG10–IG15)

IG77. The following Example illustrates the proposed guidance in paragraphs IG10–IG15 on accounting for the sale of a product with a warranty.

Example 21—Separate performance obligation for service

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

To account for the warranty, the entity must determine whether any of the warranty should be accounted for as a separate performance obligation. Because the warranty includes the training services that are a service to the customer in addition to assurance that the product complies with agreed-upon specifications, the entity would account for the training services as a separate performance obligation. Hence, the entity would allocate a portion of the total transaction price to that performance obligation. In addition, the entity would account for the assurance-type warranty in accordance with the requirements on product warranties in Subtopic 460-10.

Customer options for additional goods or services (paragraphs IG20–IG24)

IG78. The following Examples illustrate the proposed guidance in paragraphs IG20–IG22 on determining whether an option provides a customer with a material right.

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

An entity enters into a contract for the sale of Product A for \$100. As part of the contract, the entity gives the customer a 40 percent discount voucher for any future purchases in the next 30 days up to \$100. The entity intends to offer a 10 percent discount on all sales during the next 30 days as part of a seasonal promotion.

Example 22—Option that provides the customer with a material right (continued)

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

To allocate a portion of the transaction price to the separate performance obligation for the discount voucher, the entity estimates an 80 percent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase \$50 of additional products. Because the entity intends to offer a 10 percent discount to all customers as part of a seasonal promotion, the 40 percent discount that the customer would obtain when exercising the voucher needs to be reduced by 10 percentage points to 30 percent to reflect the incremental value of the discount to the customer. Hence, the entity's estimated standalone selling price of the discount voucher is \$12 (\$50 average purchase of additional products × 30% incremental discount × 80% likelihood of exercising the option).

If the standalone selling price of Product A is \$100, the entity allocates \$10.7 $\{ \$100 \times [12 \div (12 + 100)] \}$ of the \$100 transaction price to the discount voucher.

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

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

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

Example 23—Option that does not provide the customer with a material right (continued)

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

- IG79. The following Example illustrates the proposed guidance in paragraph IG23 on determining the amount of the transaction price to allocate to an option as part of a customer loyalty program.

Example 24—Customer loyalty program

An entity has a customer loyalty program that rewards a customer with 1 customer loyalty point for every \$10 of purchases. Each point is redeemable for a \$1 discount on any future purchases. During a reporting period, customers purchase products for \$100,000 and earn 10,000 points redeemable for future purchases. The standalone selling price of the purchased products is \$100,000. The entity expects 9,500 points to be redeemed on the basis of its past experience that it concludes is predictive of the amount of consideration to which it will be entitled. The entity estimates a standalone selling price of \$0.95 per point (or \$9,500 total) on the basis of the likelihood of redemption.

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

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

| | |
|---------|-----------------------|
| Product | \$91,324 ^a |
| Points | \$8,676 ^b |

^a $\$100,000 \times \$100,000 \div \$109,500$

^b $\$100,000 \times \$9,500 \div \$109,500$

Example 24—Customer loyalty program (continued)

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

During the second reporting period, an additional 4,000 points are redeemed (cumulative points redeemed are 8,500). The entity expects that 9,700 points will be redeemed in total. The cumulative revenue that the entity recognizes is \$7,603 $[(8,500 \div 9,700) \times \$8,676]$. The entity has recognized \$4,110 in the first reporting period, so it recognizes revenue for the loyalty points of \$3,493 $(\$7,603 - \$4,110)$ in the second reporting period.

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

- IG80. The following Example illustrates the proposed guidance in paragraph IG24 on using a practical alternative to determine the amount of the transaction price to allocate to an option for a renewal of annual maintenance services.

Example 25—Maintenance services with a renewal option

An entity enters into 100 contracts to provide 1 year of maintenance services for \$1,000 per contract. At the end of the year, each customer has the option to renew the contract for a second year by paying an additional \$1,000. Customers who renew for a second year are also granted the option to renew for a third year under the terms of the existing contract.

The entity concludes that the renewal option provides a material right to the customer because the entity expects to undertake progressively more maintenance work each year if a customer renews. Part of each customer's payment of \$1,000 in the first year is, in effect, a nonrefundable prepayment of services to be provided in a subsequent year. Hence, the option is a separate performance obligation.

**Example 25—Maintenance services with a renewal option
(continued)**

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

The entity expects 90 percent of customers to renew at the end of Year 1 and 90 percent of those customers to renew at the end of Year 2.

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

The expected amount of consideration for each contract that is renewed twice is \$2,710 [$\$1,000 + (90\% \times \$1,000) + (90\% \times 90\% \times \$1,000)$]. The entity determines that recognizing revenue on the basis of costs incurred relative to total expected costs would depict the transfer of services to the customer. For a contract that is renewed twice and extended to 3 years, the estimated costs in Years 1–3 are as follows:

| | |
|--------|---------|
| Year 1 | \$ 600 |
| Year 2 | \$ 750 |
| Year 3 | \$1,000 |

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

| Expected Costs Adjusted for Likelihood of Contract Renewal | Allocation of Consideration Expected |
|---|--|
| Year 1 \$ 600 ($\$600 \times 100\%$) | \$ 780 ($\$600 \div \$2,085 \times \$2,710$) |
| Year 2 675 ($\$750 \times 90\%$) | 877 ($\$675 \div \$2,085 \times \$2,710$) |
| Year 3 <u>810</u> ($\$1,000 \times 81\%$) | <u>1,053</u> ($\$810 \div \$2,085 \times \$2,710$) |
| <u>\$2,085</u> | <u>\$2,710</u> |

**Example 25—Maintenance services with a renewal option
(continued)**

Therefore, at the end of Year 1, the entity allocates to the option \$22,000 of the consideration received to date [cash of \$100,000 – revenue recognized of \$78,000 ($\780×100)]. The entity allocates \$24,300 to the option at the end of Year 2 [cumulative cash of \$190,000 – cumulative revenue recognized of \$165,700 ($\$78,000 + \877×100)].

Licensing (paragraphs IG33–IG37)

- IG81. The following Example illustrates the proposed guidance in paragraphs IG33–IG37 on licensing.

Example 26—Franchise rights

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

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

In accordance with paragraph 28, the rights to the trade name, market area, and proprietary know-how for five years are not individually distinct because individually they are not sold separately and cannot be used with other goods or services that are readily available to the customer. However, on a combined basis, those rights are distinct because they can be used together

Example 26—Franchise rights (continued)

with other services that are readily available to the customer. Hence, those combined rights give rise to a separate performance obligation. The entity satisfies the performance obligation to grant those rights at the point in time when the customer obtains control of the rights (that is, commencement of operations by the customer).

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

The entity's promise to stand ready to provide products to the customer in the future would not be accounted for as a separate performance obligation in the contract because it does not provide the customer with a material right (as described in paragraph IG22).

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

This proposed Update was approved for publication by six members of the Financial Accounting Standards Board. Mr. Linsmeier dissented from publication of the proposed Update. His alternative view is set out at the end of the Basis for Conclusions along with the alternative view of Mr. Jan Engström of the International Accounting Standards Board.

Members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information, Basis for Conclusions, and Alternative Views

Introduction

- BC1. This basis for conclusions summarizes the Boards' considerations in developing the proposed guidance for revenue (and some costs) from contracts with customers. It includes the reasons for accepting particular views and rejecting others. Individual Board members gave greater weight to some factors than to others.
- BC2. This basis for conclusions discusses the following matters:
- (a) Background (paragraphs BC3–BC28)
 - (b) Scope (paragraphs BC29–BC46)
 - (c) Identifying the contract (paragraphs BC47–BC61)
 - (d) Identifying performance obligations (paragraphs BC62–BC81)
 - (e) Satisfaction of performance obligations (paragraphs BC82–BC123)
 - (f) Measurement of revenue (paragraphs BC124–BC162)
 - (g) Collectibility (paragraphs BC163–BC175)
 - (h) Allocating the transaction price to separate performance obligations (paragraphs BC176–BC197)
 - (i) Constraint on the cumulative amount of revenue recognized (paragraphs BC198–BC203)
 - (j) Onerous performance obligations (paragraphs BC204–BC216)
 - (k) Contract costs (paragraphs BC217–BC234)
 - (l) Presentation (paragraphs BC235–BC242)
 - (m) Disclosure (paragraphs BC243–BC273)
 - (n) Implementation guidance (paragraphs BC274–BC325)
 - (o) Transition, effective date, and early adoption (paragraphs BC326–BC335)
 - (p) Benefits and costs (paragraphs BC336–BC344)
 - (q) Consequential amendments (paragraphs BC345–BC351)
 - (r) Application to nonpublic entities (paragraphs BC352–BC370)
 - (s) Alternative view (paragraphs BC371–BC380).

Background

- BC3. The FASB and the IASB initiated a joint project to improve the financial reporting of revenue under U.S. GAAP and IFRSs. The Boards decided that their existing requirements on revenue needed improvement for the following reasons:

- (a) U.S. GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions, which can result in different accounting for economically similar transactions.
 - (b) The two main revenue standards in IFRSs have different principles and can be difficult to understand and apply to transactions beyond simple transactions. In addition, IFRSs have limited guidance on important topics such as revenue recognition for multiple-element arrangements. Consequently, some entities that apply IFRSs refer to parts of U.S. GAAP to develop an appropriate revenue recognition accounting policy.
 - (c) The disclosures required under both U.S. GAAP and IFRSs are inadequate and lack cohesion with the disclosures of other items in the financial statements.
- BC4. The Boards decided to eliminate those inconsistencies and weaknesses by developing a comprehensive revenue recognition model that would apply to a wide range of transactions and industries. The Boards decided that this approach also would improve U.S. GAAP and IFRSs by:
- (a) Providing a more robust framework for addressing revenue recognition issues
 - (b) Improving comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets
 - (c) Simplifying the preparation of financial statements by reducing the number of requirements to which entities must refer
 - (d) Requiring enhanced disclosures to help users of financial statements better understand the amount, timing, and uncertainty of revenue that is recognized.
- BC5. In December 2008, the Boards published for public comment the Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers*, and received more than 200 comment letters in response. In the Discussion Paper, the Boards proposed the general principles of a contract-based revenue recognition model with a measurement approach based on an allocation of the transaction price. That revenue model was developed after the Boards held extensive discussions on alternative models for recognizing and measuring revenue (see paragraphs BC17–BC28).
- BC6. Respondents generally supported the objective of developing a comprehensive revenue recognition model for both U.S. GAAP and IFRSs. Most respondents also generally supported the recognition and measurement principles proposed in the Discussion Paper, which are the basic building blocks of the revenue model. In particular, the Discussion Paper introduced the concepts of a contract containing performance obligations for the entity to transfer goods or services to a

customer and that revenue is recognized when the entity satisfies its performance obligations as a result of the customer obtaining control of those goods or services. Respondents to the Discussion Paper were mainly concerned about the proposals to:

- (a) Identify separate performance obligations only on the basis of the timing of the transfer of the good or service to the customer— Respondents commented that this would be impractical, especially when many goods or services are transferred over time to the customer (for example, in construction contracts).
- (b) Use the concept of control to determine when a good or service is transferred—Respondents asked for clarification of the control concept to avoid the implication that the proposals would require completed contract accounting for all construction contracts (that is, revenue is recognized only when the customer obtains legal title or physical possession of the completed asset).

BC7. The Boards considered those comments when developing the Exposure Draft, *Revenue from Contracts with Customers* (the FASB's Exposure Draft was a proposed Accounting Standards Update), which was published in June 2010. Nearly 1,000 comment letters were received from a wide range of industries, including construction, manufacturing, telecommunications, technology, pharmaceutical, biotechnology, financial services, consulting, entertainment, energy and utilities, freight and logistics, and industries with significant franchising operations, such as hospitality and fast food restaurant chains. Some of the concerns raised by those respondents were specific to their industry, but many concerns were shared by respondents across various industries.

BC8. The Boards also received a substantial number of comment letters in response to a question asked by the FASB on whether the proposals should apply to nonpublic entities. Almost all of those comment letters were from respondents associated with sections of the U.S. construction industry (for example, private construction contractors, accounting firms that serve those contractors, and surety providers who use the financial statements of construction contractors when deciding whether to guarantee that those contractors will meet their obligations under a contract). Those respondents raised concerns about the application of the proposed model to nonpublic entities. Those issues were discussed separately by the FASB.

BC9. The Boards and their staffs also consulted extensively on the proposals in the 2010 proposed Update. Roundtable discussions were held in London (United Kingdom), Kuala Lumpur (Malaysia), and in Norwalk, Connecticut and Palo Alto, California (United States of America). Members of the Boards and the staffs also participated in conferences, working group sessions, discussion forums, and one-to-one discussions that were held across all major geographical regions. Targeted outreach

to develop and refine the proposals involved representatives from accounting firms, local standard setters, regulators, users of financial statements, preparers, and affected industries (such as the real estate, construction, defense/aerospace, telecommunications, software/information technology, media, and pharmaceutical industries).

- BC10. With the exception of many of the responses from nonpublic entities in the construction industry, most of the feedback from the comment letters and from the consultation activities generally supported the Boards' proposal for a comprehensive revenue recognition model for both U.S. GAAP and IFRSs. Moreover, most respondents supported the core principle of that model, which is that an entity should recognize revenue to depict the transfer of goods or services to a customer in an amount that reflects the amount of consideration for those goods or services.
- BC11. Almost all respondents to the 2010 proposed Update indicated that the Boards needed to further clarify the operation of the core principle. In particular, respondents were concerned about the application of the following:
- (a) The concept of control and, in particular, the application of the indicators of the transfer of control to service contracts and contracts for the transfer of an asset over time to a customer as it is being constructed (that is, a work-in-process asset)
 - (b) The principle of distinct goods or services for identifying separate performance obligations in a contract. Many respondents were concerned that the principle, as proposed in the 2010 proposed Update, would lead to inappropriate disaggregation of the contract.
- BC12. Many of those respondents were concerned that those proposals could be difficult to apply consistently across a wide range of industries and may produce accounting outcomes that do not faithfully portray the entity's contracts with customers and the entity's performance under those contracts. Some respondents were concerned that the Boards' objective of comparability of revenue recognition practices across industries might be achieved only at the cost of losing the current levels of comparability in the revenue recognition practices within each industry. Consequently, some of those respondents suggested that the Boards might need to develop industry-specific guidance or create industry-specific exceptions to the general principles.
- BC13. The Boards addressed those concerns during the redeliberations of the proposals in the 2010 proposed Update. A summary of the changes that the Boards made to those proposals is presented in Appendix B. In many cases, those changes either clarify the Boards' intentions in the 2010 proposed Update (either by articulating the proposals differently or

by adding guidance) or simplify those proposals. In some cases, the changes have resulted in revised guidance that aligns more closely with existing guidance or current practice than did the proposals in the 2010 proposed Update.

- BC14. As the redeliberations of those proposals drew to a close, the Boards decided to reexpose the proposed guidance for public comment to provide interested parties with an opportunity to comment on revisions that the Boards have made since the 2010 proposed Update was issued. The Boards decided unanimously that it was appropriate to go beyond their established due process and to reexpose their revised revenue proposals because of the importance of the revenue number to all entities and the desire to avoid unintended consequences in the recognition of revenue for specific contracts or industries.

Why make the change?

- BC15. Some respondents to the Discussion Paper and to the 2010 proposed Update questioned the need to replace existing guidance on revenue recognition—in particular, those requirements that seem to work reasonably well in practice and provide useful information about the different types of contracts for which they are intended.
- (a) For U.S. GAAP, some questioned whether a new revenue recognition model is necessary because Accounting Standards Update No. 2009-13, *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements*, has resolved some of the issues that the revenue recognition project set out to resolve. Furthermore, the *FASB Accounting Standards Codification*[®] has simplified the process of accessing and researching existing guidance on revenue.
 - (b) For IFRSs, some indicated that the IASB could improve its existing standards by developing additional requirements on critical issues (for example, multiple-element arrangements) without replacing existing standards.
- BC16. The Boards acknowledge that it would be possible to improve many existing revenue recognition requirements without replacing them. However, in the Boards' view, even after the changes to U.S. GAAP mentioned above, the existing requirements in U.S. GAAP and IFRSs would continue to result in inconsistent accounting for revenue and, consequently, would not provide a robust framework for addressing revenue recognition issues in the future. Furthermore, amending existing requirements would fail to achieve one of the goals of the revenue recognition project—to develop a common revenue standard for U.S. GAAP and IFRSs that entities can apply consistently across industries, jurisdictions, and capital markets. Because revenue is a

crucial number to users of financial statements, the Boards considered that having a common standard on revenue for U.S. GAAP and IFRSs is an important step toward achieving the goal of a single set of high-quality global accounting standards. Consistent with that goal, the Boards noted that existing revenue recognition guidance in U.S. GAAP and IFRSs should not be used to supplement the principles in the proposed guidance.

Alternative revenue recognition models

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

Basis for recognizing revenue

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

the remaining rights and performance obligations. If the measure of the remaining rights exceeds the measure of the remaining performance obligations, the contract is an asset (a contract asset). Conversely, if the measure of the remaining performance obligations exceeds the measure of the remaining rights, the contract is a liability (a contract liability).

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

goods or services are transferred to the customer, would provide users of financial statements with more useful information.

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

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

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

Basis for measuring revenue

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

- (a) An entity would recognize revenue before transferring goods or services to the customer at contract inception if the measure of rights to consideration exceeds the measure of the remaining performance obligations. That would be a typical occurrence at contract inception because the transaction price often includes amounts that enable an entity to recover its costs to obtain a contract.
- (b) Any errors in identifying or measuring performance obligations could affect revenue recognized at contract inception.
- (c) A current exit price for the remaining performance obligations would typically not be observable, and an estimated current exit price could be complex and costly to prepare and difficult to verify.

BC27. Almost all responses to the Discussion Paper supported the Boards' proposal to measure performance obligations using an allocated transaction price approach.

BC28. The Boards also considered in the Discussion Paper whether it would be appropriate to require an alternative measurement approach for only some performance obligations (for example, performance obligations with highly variable outcomes for which an allocated transaction price approach may not result in useful information). The Boards rejected that approach in developing the proposals for the 2010 proposed Update because a common type of contract with customers that has highly variable outcomes would be an insurance contract, which is excluded from the scope of the proposed guidance. The Boards decided that the benefits of accounting for all performance obligations within the scope of the proposed guidance using the same measurement approach outweighed any concerns about using that approach for some performance obligations.

Scope (paragraphs 9–11)

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

- (a) Dividends
- (b) For IFRSs, changes in the value of biological assets, investment properties, and the inventory of commodity broker traders

- (c) For U.S. GAAP, changes in regulatory assets and liabilities arising from alternative revenue programs for rate-regulated entities. (The FASB decided that the revenue arising from those assets or liabilities should be presented separately from revenues arising from contracts with customers.)
- BC30. The proposed guidance does not amend the existing definitions of revenue in each Board’s conceptual framework. The Boards decided that the definition of revenue is a matter for consideration in their joint project on the conceptual framework. However, the IASB decided to carry forward into its proposed guidance the description of revenue from the IASB’s *Conceptual Framework for Financial Reporting* rather than the definition of revenue from IAS 18. The IASB noted that the IAS 18 definition refers to “gross inflow of economic benefits” and the IASB had concerns that some may misread that reference as implying that an entity should recognize as revenue a prepayment from a customer for goods or services. As described in paragraphs BC18–BC25, revenue would be recognized in accordance with the proposed guidance only as a result of an entity satisfying a performance obligation in a contract with a customer. In addition, the FASB decided to carry forward a definition of revenue that is based on the definition in FASB Concepts Statement No. 6, *Elements of Financial Statements*.
- BC31. The definitions of a *contract* and a *customer* establish the scope of the proposed guidance.

Definition of a contract (Appendix A)

- BC32. The definition of a contract is based on common legal definitions of a contract in the United States and is similar to the definition of a contract used in IAS 32, *Financial Instruments: Presentation*. The IASB decided not to adopt a single definition of a contract for both IAS 32 and the proposed guidance because the IAS 32 definition implies that contracts can include agreements that are not enforceable by law. Including such agreements would be inconsistent with the Boards’ decision that a contract with a customer must be enforceable by law for an entity to recognize the rights and obligations arising from that contract. The IASB also noted that amending the IAS 32 definition would pose the risk of unintended consequences in accounting for financial instruments.
- BC33. The definition of a contract emphasizes that a contract exists when an agreement between two or more parties creates enforceable rights and obligations between those parties. The Boards noted that such an agreement does not need to be in writing to be a contract. Whether the agreed terms are written, oral, or evidenced otherwise, a contract exists if the agreement creates rights and obligations that are enforceable against the parties. Determining whether a contractual right or obligation

is enforceable is a question of law, and the factors that determine enforceability may differ between jurisdictions. Although the contract must be legally enforceable, the Boards decided that the performance obligations within the contract could include promises that result in the customer having a valid expectation that the entity will transfer goods or services to them even though those promises are not enforceable. This is discussed further in paragraph BC63.

BC34. The Boards decided to complement the contract definition by specifying (in paragraph 14) the following attributes of a contract that must be present before an entity can apply the proposed guidance. Those attributes are derived mainly from existing guidance:

- (a) The contract has commercial substance—The Boards decided to include commercial substance as an attribute of a contract with a customer when they discussed whether revenue should be recognized for nonmonetary exchanges. Such transactions have been an area of financial reporting abuse, with entities transferring goods or services back and forth to each other (often for little or no cash consideration), thereby artificially inflating their revenues. Therefore, the Boards decided that an entity should not recognize revenue from a nonmonetary exchange if the exchange has no commercial substance. The Boards decided to describe commercial substance consistently with its existing meaning in other financial reporting contexts, such as existing guidance for nonmonetary exchange transactions. Because other types of contracts also could lack commercial substance, the Boards decided that all contracts should have commercial substance to be within the scope of the proposed guidance.
- (b) The parties to the contract have approved the contract and are committed to perform their respective obligations—The Boards decided to include those factors as attributes of a contract with a customer because if the parties to a contract have not approved the contract, it is questionable whether that contract is legally enforceable. Some respondents questioned whether oral and implied contracts could meet the requirement that “the parties to the contract have approved the contract,” especially if it is difficult to verify the entity’s approval of that contract. The Boards decided that the form of the contract does not, in and of itself, determine whether the parties have approved and are committed to the contract. Instead, an entity should consider all relevant facts and circumstances in assessing whether the parties intend to be bound by the terms and conditions of the contract. Consequently, in some cases, the parties to an oral or implied contract (in accordance with customary business practices) may have the intent and the commitment to fulfill their respective

obligations. In other cases, a written contract may be required to determine that the parties to the contract have approved and are committed to perform under the contract.

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

- (c) The entity can identify each party's rights regarding the goods or services to be transferred—This attribute is necessary because an entity would not be able to assess the transfer of goods or services if the entity cannot identify each party's rights regarding those goods or services.
- (d) The entity can identify the payment terms for the goods or services to be transferred—This attribute is necessary because an entity would not be able to determine the transaction price if the entity cannot identify the payment terms in exchange for the promised goods or services. Respondents from the construction industry questioned whether an entity can identify the payment terms for unpriced change orders (that is, change orders for which the scope of work may be defined even though the specific amount of consideration for that work has not yet been determined and may not be finally determined for a period of time). The Boards clarified that their intention was not to preclude revenue recognition for unpriced change orders if the scope of the work has been approved and thus the entity has a right to payment for the additional work performed. The Boards affirmed that the consideration need not be fixed to identify the payment terms. Hence, the entity would determine the transaction price on the basis of the proposed guidance in paragraphs 50–67.

BC35. The Boards decided that the proposed revenue guidance should not apply to wholly unperformed contracts if each party to the contract has the unilateral enforceable right to terminate the contract without penalty. Accounting for those contracts would not affect an entity's financial position or performance until either party performs. In contrast, there could be an effect on an entity's financial position and performance if only one party could terminate a wholly unperformed contract without penalty. For instance, if only the customer could terminate the wholly

unperformed contract without penalty, the entity is obliged to stand ready to perform at the discretion of the customer. And, if only the entity could terminate the wholly unperformed contract without penalty, the entity has an enforceable right to payment from the customer if the entity chooses to perform. In accordance with the proposed guidance, an entity's rights and obligations in wholly unperformed contracts would be measured at the same amount and, therefore, would offset each other. However, by including those contracts within the scope of the proposed guidance, an entity would provide additional information about a change in the entity's financial position that resulted from entering into those contracts. That would involve the entity recognizing a liability if a performance obligation in that contract is onerous (in accordance with paragraphs 86–90) or disclosing the amount of transaction price allocated to the remaining performance obligations in that wholly unperformed contract (in accordance with paragraphs 119–121).

Definition of a customer (Appendix A)

- BC36. The purpose of defining a customer is to distinguish a revenue contract from other contracts into which an entity enters. Some respondents asked the Boards to clarify the meaning of *ordinary activities* in the definition of a customer. However, that notion was derived from the existing definitions of revenue. In particular, the IASB's *Conceptual Framework* definition of *revenue* refers specifically to the "ordinary activities of an entity" and the definition of *revenue* in Concepts Statement 6 refers to the notion of an entity's "ongoing major or central operations." As noted in paragraph BC30, the Boards are not reconsidering those definitions in the revenue project.
- BC37. When considering the definition of a customer, the Boards observed that revenue could be recognized from transactions with partners or participants in a collaborative arrangement. Those arrangements would be within the scope of the proposed guidance only if the other party to the arrangement meets the definition of a customer. Some industry respondents asked the Boards to clarify whether parties to common types of arrangements in their industries would meet the definition of a customer. However, the Boards decided that it would not be feasible to develop implementation guidance that would apply uniformly to various industries because the terms and conditions of a specific arrangement may affect whether the parties to the arrangement have a supplier-customer relationship or some other relationship (for example, as collaborators or as partners). Therefore, an entity would need to consider all relevant facts and circumstances in assessing whether the counterparty meets the definition of a customer. Examples of arrangements in which an entity would need to make such an assessment are as follows:

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

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

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

- (a) It would gross up revenues and expenses and make it difficult for users of financial statements to assess the entity's performance and gross margins during the reporting period.
- (b) Some view the counterparty in those arrangements as also acting as a supplier and not as a customer.

BC39. The Boards considered modifying the definition of a customer. However, they rejected that alternative because of concerns about unintended consequences. Therefore, the Boards decided to exclude from the scope of the proposed guidance nonmonetary exchanges between entities in the same line of business to facilitate sales to customers, or to potential customers, other than the parties to the exchange.

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

BC40. The Boards excluded from the scope of the proposed guidance three types of contracts with customers that the Boards are addressing in other standard-setting projects:

- (a) Leases

- (b) Insurance contracts
 - (c) Financial instruments and other contracts within the scope of the financial instruments standards.
- BC41. The FASB also decided to exclude from the scope of the proposed guidance guarantees (other than product warranties) that are within the scope of Topic 460 on guarantees. The focus of the existing accounting guidance for those guarantee arrangements relates primarily to recognizing and measuring a guarantee liability.
- BC42. Some respondents reasoned that excluding some contracts with customers from the scope of the proposed guidance could perpetuate the development of industry-specific or transaction-specific revenue guidance, which would be inconsistent with the revenue project's stated objective. The Boards disagreed with that view. In the Boards' view, the proposed guidance would provide them with a framework for considering revenue issues in other standard-setting projects. Any departure from the proposed revenue guidance would arise because the Boards have decided that, in the context of those other projects, a different basis of accounting for those contracts with customers would provide users of financial statements with more useful information.
- BC43. Many respondents expressed concerns about how the revenue model would apply to construction-type contracts and asked the Boards to retain existing guidance for those contracts. The Boards discussed those concerns on various occasions with representatives from the construction industry and observed that the concerns were partly attributable to a misperception that the proposals would require completed contract accounting for contracts currently within the scope of Subtopic 605-35 on construction-type and production-type contracts or IAS 11, *Construction Contracts*. In addition, many in the construction industry were concerned about the costs of accounting for a single construction contract as many performance obligations. In the 2010 proposed Update, the Boards clarified that not all construction contracts would result in an entity recognizing revenue only at completion of the contract. Furthermore, as discussed below, the proposed guidance provides further clarity on identifying separate performance obligations in construction contracts and determining when those performance obligations are satisfied over time. Hence, the Boards affirmed their view that the proposed guidance should apply to construction contracts.

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

- BC44. Some contracts with customers would be partially within the scope of the proposed guidance and partially within the scope of other standards (for example, a lease with a service). In those cases, the Boards

decided that it would be inappropriate for an entity to account for the entire contract in accordance with one or another standard because it could result in different accounting outcomes, depending on whether the goods or services were sold on a standalone basis or together with other goods or services.

- BC45. The Boards decided that the proposed guidance should be the default approach for separating a contract and allocating consideration to each part. However, specific issues could arise in separating contracts that are not within the scope of the proposed guidance. For example, a financial instrument or an insurance contract might require an entity to provide services that are best accounted for in accordance with the standards on financial instruments or insurance contracts.
- BC46. Therefore, the Boards decided that if other standards specify how to separate and/or initially measure parts of a contract, an entity should first apply that guidance. In other words, the more specific standard would take precedence in accounting for a part of a contract. The Boards' decision is consistent with the existing requirements on multiple-element arrangements in Subtopic 605-25.

Identifying the contract (paragraphs 12–15)

- BC47. In most cases, an entity would apply the proposed guidance to a single contract with a customer. However, the structure and scope of contracts can vary depending on how the parties to a contract decide to record their agreement. For instance, there may be legal or commercial reasons for the parties to use more than one contract to record the sale of related goods or services or to use a single contract to record the sale of unrelated goods or services. The Boards' objective in developing the proposed guidance is that the accounting for a contract should depend on an entity's present rights and obligations rather than on how the entity structures the contract. Consistent with that objective, if an entity enters into a contract with a customer that can be renewed or cancelled by either party at discrete points in time, the entity would account separately for its rights and obligations (that is, as a separate contract) for each period for which the contract cannot be cancelled by either party.
- BC48. In the 2010 proposed Update, the Boards proposed to meet the objective of identifying a contract by prescribing when an entity should account for more than one contract as a single contract (that is, a contract combination requirement) and when it should account for segments of a single contract as separate contracts (that is, a contract segmentation requirement). The Boards proposed using a principle of "price interdependence/independence" for this purpose. Price

interdependence is a common principle that underlies the requirements in existing standards (for example, Subtopics 605-25 and 605-35 and IASs 11 and 18) on combining contracts. The Boards also proposed using the same principle of price interdependence to determine whether a contract modification should be accounted for as a modification to an existing contract or as a separate contract.

BC49. In their redeliberations on the 2010 proposed Update, the Boards decided to eliminate the step of segmenting a contract into separate (hypothetical) contracts because that step is unnecessary. The Boards noted that the proposed requirement to identify the separate performance obligations in a contract achieves the same result as accounting for the separate components of a contract. Furthermore, although the Boards proposed segmenting a contract in order to restrict the allocation of the transaction price (including discounts or subsequent changes in the transaction price), the Boards decided to address those matters directly in the proposed requirements on allocation (see paragraphs BC176–BC192).

BC50. The Boards' redeliberations on the use of the principle of price interdependence in accounting for contract combinations and contract modifications are discussed in the following sections.

Combination of contracts (paragraphs 16 and 17)

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

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

Those indicators were similar to those in existing standards.

BC52. Although most respondents agreed that an entity should consider price interdependence for determining whether to combine contracts, some respondents commented that the notion of price interdependence would be too confusing as the overall principle for combining contracts. For instance, it could be difficult to determine whether a discount offered on one contract arises because of price interdependency with another contract or because the discount relates to an existing customer relationship that arises from previous contracts. Making that distinction

would be particularly difficult for entities that negotiate each contract *individually* instead of entering into contracts with standard terms. Some respondents also were concerned that the notion of price interdependence was too broad and could result in an entity being required to combine an initial contract with subsequent contracts between the entity and the customer, including subsequent contracts that arise from the exercise of options in the initial contract.

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

Contract modifications (paragraphs 18–22)

- BC55. A contract modification is a change in the scope or the price of a contract (or both). For contract modifications that amend only the contract price (that is, there is no change to the performance obligations), the Boards decided that the subsequent change to the

transaction price arising from those modifications should be accounted for consistently with changes in the transaction price in accordance with paragraphs 77–80.

- BC56. For all other contract modifications, the Boards decided that some modifications change the existing terms and conditions of a contract and other modifications effectively create new or separate contracts. In the 2010 proposed Update, the Boards proposed that an entity should distinguish between those modifications by assessing whether the prices of the modification and the existing contract are interdependent. If those prices are interdependent, an entity would account for the modification together with the existing contract and the entity would recognize the cumulative effect of the modification in the period in which the modification occurs (that is, the modification would be accounted for on a cumulative catch-up basis). If those prices are not interdependent, the entity would account for the modification as a separate contract (that is, the modification would be accounted for prospectively).
- BC57. Respondents generally agreed that contract modifications can have different effects on an entity's rights and obligations and, therefore, the accounting for those modifications should reflect those differences. However, many respondents commented that distinguishing contract modifications on the basis of whether the prices of the modification and the existing contract are interdependent could produce anomalous outcomes. For instance, an entity could be required to account for some contract modifications on a cumulative catch-up basis even though the modification relates only to the remaining performance obligations in the contract. Conversely, an entity could be required to account for other modifications as separate contracts even though the modifications relate to the original contract (for example, change orders in construction industry). Instead of relying only on the principle of price interdependence to distinguish contract modifications, many respondents suggested that factors such as risk or the degree of functionality between the goods or services being provided in the contract(s) should be relevant for determining whether an entity should account for a contract modification as a separate contract or as part of the existing contract. Those factors are consistent with the principles underlying the Boards' revised criteria for identifying distinct goods or services.
- BC58. The Boards agreed with the feedback that the principle of "price interdependence" was insufficient for determining whether to account for a contract modification as a separate contract or as a modification of an existing contract. Consequently, the Boards decided to develop specific criteria for distinguishing contract modifications. In developing those criteria, the Boards agreed that, consistent with the core principle of the proposed Update, an entity should account for a modification as a

separate contract if the effects of the modification do not affect the amount or timing (that is, pattern) of revenue recognition for the existing contract. The Boards decided that a contract modification would not change the pattern of revenue recognition for the existing contract if both of the following criteria are met:

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

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

BC60. If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied (that is, a performance obligation satisfied over time), the Boards decided that an entity should recognize the effect of the modification on a cumulative catch-up basis by updating the transaction price and the measure of progress for that performance obligation. That approach is particularly relevant and generally accepted in the construction industry because a modification to the contract typically would not result in the transfer of additional goods or services that are distinct from those promised in the existing contract and, accordingly, the modification affects the entity's measure of progress toward completion of the contract.

BC61. Some respondents to the 2010 proposed Update questioned how the guidance would apply to unpriced change orders (as described in paragraph BC34(d)), which are common in the construction industry. The Boards noted that once the parties have approved a change in the scope of the contract, the entity would have a right to payment for work performed. However, because the change order is unpriced, there is uncertainty about the amount of consideration that will be paid. Thus, the Boards clarified that in these cases, an entity would apply the proposed guidance for a contract modification when the entity has an expectation that the price of the modification will be approved. The entity would then be able to determine the transaction price in accordance with paragraphs 50–67 and whether the recognition of revenue should be constrained in accordance with paragraphs 81–85.

Identifying performance obligations

Definition of a performance obligation (Appendix A)

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

BC63. The 2010 proposed Update proposed a similar definition of a performance obligation. However, the proposed definition in the 2010 proposed Update specified that the promise must be enforceable. Respondents to the 2010 proposed Update expressed concerns about the term *enforceable* because they thought that an entity should account for some promised goods or services as performance obligations even though the promise to transfer those goods or services may not be enforceable (for example, some when-and-if-available software upgrades and award credits associated with customer loyalty programs). Consequently, the Boards decided that although a contract with a customer must be enforceable, a performance obligation could arise from a promise associated with a contract if the customer has a valid expectation that the entity will transfer a good or service. In making that decision, the Boards noted that identifying a performance obligation based on such promises is consistent with both of the following:

- (a) The core principle of the proposed Update, because an entity would account for promised goods or services that the customer reasonably expects to receive and for which the customer promises to pay
- (b) The current application of U.S. GAAP and IFRSs (for example, the definition of a *constructive obligation* in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*).

Marketing incentives, incidental obligations, and perfunctory obligations

- BC64. Some respondents to the 2010 proposed Update suggested that an entity should account for some promised goods or services as marketing expenses or as incidental obligations even though those promises meet the definition of a performance obligation. Examples of such promised goods or services include “free” handsets provided by telecommunication entities and customer loyalty points awarded by supermarkets, airlines, and hotels. Those respondents thought that revenue should be recognized only for the main goods or services for which the customer has contracted and not for the marketing incentives and other incidental obligations.
- BC65. When a customer contracts with an entity for a bundle of goods or services, it can be difficult and subjective for the entity to identify the “main” goods or services for which the customer has contracted. In addition, the outcome of that assessment could vary significantly depending on whether an entity performs the assessment from the perspective of its business model or from the perspective of the customer. Consequently, the Boards decided that all goods or services promised to a customer as a result of a contract are performance obligations because they are part of the negotiated exchange between the entity and its customer. Although the entity might consider those goods or services to be marketing incentives or incidental goods or services, they are goods or services for which the customer pays and to which the entity should allocate consideration for purposes of revenue recognition. In contrast to performance obligations in a contract, marketing incentives are provided independently of the contract that the incentives are designed to secure. (See paragraphs BC296–BC304 for additional discussion on marketing incentives and the accounting for customer options to acquire additional goods or services.)
- BC66. For similar reasons, the Boards decided not to exempt an entity from accounting for performance obligations that the entity might regard as being perfunctory or inconsequential. Instead, an entity would assess whether those performance obligations are immaterial in accordance

with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, and Topic 105 on generally accepted accounting principles.

Identifying separate performance obligations (paragraphs 23–30)

- BC67. Contracts with customers can contain many performance obligations. In the Discussion Paper, the Boards proposed that an entity should refer to the timing of the transfer of the promised goods or services to identify the performance obligations that it should account for separately. Respondents to the Discussion Paper were concerned that this proposal would require an entity to account separately for every promised good or service in a contract that is transferred at a different time, which would not be practical for many contracts, especially for long-term services and construction contracts. Consequently, in developing both the 2010 proposed Update and this proposed Update, the Boards' intention was to develop clear guidance that would result in an entity identifying separate performance obligations in a way that would be both practical and result in a pattern of revenue recognition that faithfully depicts the transfer of goods or services to the customer.
- BC68. During outreach activities on the Discussion Paper and on the 2010 proposed Update, the Boards observed that, for many contracts, it is intuitive for an entity to identify the promised goods or services that the entity should account for separately. Consequently, the Boards wanted to develop a principle for identifying separate performance obligations that would be intuitive when applied across the various industries and transactions in the scope of the proposed guidance. That principle is the notion of a good or service that is distinct. The term *distinct*, in an ordinary sense, suggests something that is different, separate, or dissimilar. However, to avoid the significant diversity in practice that could result from the proposed guidance relying too heavily on the judgment of an entity about whether a good or service is distinct, the Boards decided to specify when a good or service is distinct.
- BC69. In the 2010 proposed Update, the Boards proposed that a good or service is distinct if it is sold separately (by the entity or by another entity) or if it could be sold separately. The Boards were concerned that requiring an entity to account separately (and estimate a standalone selling price) for a good or service that is not capable of being sold separately might result in information that would not be useful to users of financial statements. The Boards specified in the 2010 proposed Update that a good or service must have both of the following attributes to be capable of being sold separately:
- (a) A distinct function (that is, the good or service must have utility either on its own or together with other goods or services that the

customer has acquired from the entity or that are sold separately by the entity or another entity)

- (b) A distinct profit margin (that is, the good or service must be subject to distinct risks and the entity must be able to separately identify the resources needed to provide the good or service).

BC70. A majority of respondents to the 2010 proposed Update agreed with using the principle of “distinct” to identify the separate performance obligations in a contract. However, many respondents were still concerned that applying the criteria for determining when a good or service is distinct would not be practical and would result in an entity unbundling a contract into components that are identified without considering the economics of the transaction. Those concerns related mainly to the proposal that a good or service is distinct if it is sold separately by the entity or by another entity. Some respondents commented that the experience of other entities, including entities that operate in other markets or other jurisdictions, could be costly to obtain and would not be relevant for determining whether an entity should account separately for a promised good or service. In addition, respondents were concerned that many construction- and production-type contracts would be accounted for as many separate performance obligations because each component of the contract is sold separately (for example, by a subcontractor or by a supplier of building materials). Respondents thought that not only would it be impractical for an entity to account for those types of contracts as consisting of many performance obligations, but doing so would not reflect the economics of those transactions because the promised goods or services are highly interrelated and interdependent (that is, each good or service in the bundle is not distinct).

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

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

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

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

Attributes of a distinct good or service (paragraph 28)

BC73. The Boards propose two criteria that would provide evidence that a good or service is capable of being distinct. One criterion (in paragraph 28(b)) specifies that the “customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer.” That criterion expands on the notion of a distinct function in the 2010 proposed Update by clarifying that a good or service is distinct if either of the following conditions is met:

- (a) The customer can benefit from the good or service on its own (that is, the good or service is an asset that, on its own, can be used, consumed, sold for an amount other than a scrap value, held, or otherwise used in a way that generates economic benefits).
- (b) The customer can benefit from the good or service when the good or service is combined with other resources that are readily available to the customer. Readily available resources are goods or services that are sold separately (by the entity or by another entity) or resources that the customer already has obtained (from the entity or from other transactions or events).

BC74. The other criterion (in paragraph 28(a)) that “the entity regularly sells the good or service separately” is a practical expedient for determining whether a good or service would meet the criterion in paragraph 28(b). That is because, in concept, any good or service that is sold separately should be able to be used on its own or with other resources, otherwise there would be no market for an entity to provide that good or service on a standalone basis. The Boards decided to limit the scope of the practical expedient to only the entity’s standalone sales because of concerns raised previously by respondents that the experience of other entities was not relevant for determining whether a good or service is distinct.

- BC75. If a good or service is not distinct in accordance with the criteria in paragraph 28, it is questionable whether it is an asset. Hence, the Boards thought that requiring a good or service to be distinct would emphasize that an entity can have a performance obligation only for promises that, when fulfilled, would result in the transfer of an asset to the customer.
- BC76. The proposed attributes of a distinct good or service are comparable to the guidance on multiple-element arrangements in Subtopic 605-25, which specifies that a delivered item have “value to the customer on a standalone basis” for an entity to account for that item separately. However, the Boards decided against using that terminology because it could suggest that an entity must identify performance obligations on the basis of an assessment of the customer’s intended use of the promised goods or services, which would affect the “value to the customer.” It would be difficult, if not impossible, for an entity to know the customer’s intentions in any given contract. In addition, the Boards noted that an item that has value to the customer on a standalone basis is defined as an item that the customer could resell (even in a hypothetical market). Therefore, the Boards decided not to carry forward the terminology in Subtopic 605-25 as an additional criterion for determining whether a good is distinct for the following reasons:
- (a) Nearly any item could be resold by the customer (although possibly only for scrap value).
 - (b) In some circumstances, an item may be distinct but the customer may not have the ability to resell that item because of contractual restrictions (for example, to protect the entity’s intellectual property).
 - (c) The ability to resell an item is included in the criterion in paragraph 28(b), which considers a distinct good or service from the perspective of whether the customer benefits from the good or service on its own or together with other goods or services that are readily available to the customer.

Bundles of goods or services (paragraph 29)

- BC77. The Boards decided that the criteria for a distinct good or service in paragraph 28 are necessary to identify separate performance obligations but they are not sufficient. In other words, an entity must consider the attributes of an individual good or service but the entity also must consider how that good or service is bundled with other goods or services in a particular contract.
- BC78. During the redeliberations following the 2010 proposed Update, the Boards observed that, in some cases, the individual goods or services in a bundle might meet the criteria in paragraph 28, but those goods or

services would not be distinct because of the way in which the goods or services are bundled. In those cases, the risk that an entity assumes to fulfill its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risks relating to the transfer to the customer of the other promised goods or services in that bundle. Hence, the Boards considered whether to specify “separable risks” as an additional attribute of a distinct good or service. Although the Boards considered that the existence of separable risks indicated that a good or service is distinct, the Boards decided that, given the feedback on the 2010 proposed Update, the concept of inseparable risks may not be an intuitive or practical criterion for determining whether a good or service is distinct. That is because it may be difficult for an entity to determine which risks should be included in that assessment. Instead, the Boards decided to develop the following criteria to clearly identify the circumstances in which an entity promises goods or services as a bundle and the goods or services are not individually distinct because the risks of providing the bundle of goods or services are largely inseparable:

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

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

be deemed to be a single performance obligation even if the risk that the entity assumes in integrating the promised goods or services is negligible (for example, a simple installation of standard equipment).

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

Pattern of transfer (paragraph 30)

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

Satisfaction of performance obligations (paragraphs 31–47)

- BC82. In the proposed guidance, revenue would be recognized when (or as) goods or services are transferred to a customer. That is because an entity satisfies its performance obligation (that is, fulfills its promise to the customer) by transferring the promised good or service underlying

that performance obligation to the customer. Therefore, assessing when a good or service is transferred is a critical step in applying the proposed guidance.

Control

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

Developing the notion of control

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

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

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

Applying the notion of control

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

Performance obligations satisfied over time (paragraphs 35 and 36)

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

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

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

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

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

payments to support his ownership investment and to approve the facilities constructed (or goods produced or services performed) to date if they meet the contract requirements. The buyer's right to take over the work-in-progress at his option (usually with a penalty) provides additional evidence to support that view. Accordingly, the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses.

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

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

transferring an asset to another customer, the entity does not have an alternative use for that asset because it is legally obliged to direct the asset to the customer.

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

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

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

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

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

may be further away from the asset's destination), another company could fulfill the remaining obligation to the customer without having to reperform the transportation service provided to date.

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

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

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

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

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

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

- (a) An entity must have a contract to recognize revenue in accordance with the proposed guidance, and a component of a contract is a right to payment.
- (b) The core revenue recognition principle is about determining whether goods or services have been transferred to a customer, not whether the entity has a right to payment. Including a right to payment as an overarching criterion could potentially obscure that revenue recognition principle.
- (c) A right to payment does not necessarily determine a transfer of goods or services (for example, in some contracts, customers are required to make nonrefundable upfront payments and do not receive any goods or services in exchange).
- (d) In cases in which the customer clearly receives benefits as the entity performs, as in many service contracts, the possibility that the entity will not ultimately retain the payment for its performance is dealt with in measuring revenue. For example, in some service contracts that would meet the combination of the

criteria in paragraph 35(b) and paragraphs 35(b)(i) or (ii), the customer may be able to terminate the contract and receive a full refund of its consideration. In such cases, the Boards decided that because the entity is transferring services to the customer, it should recognize revenue subject to being reasonably assured of being entitled to the consideration.

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

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

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

IFRIC 15, Agreements for the Construction of Real Estate

- BC111. In developing the proposed requirements for assessing when goods or services transfer to the customer, the Boards considered the diversity in practice from applying IFRIC 15, *Agreements for the Construction of Real Estate*. That diversity in practice results from the difficulty in determining when control of a good transfers to the customer over time by applying the recognition criteria in paragraph 14 of IAS 18 to complex contracts with different facts and circumstances. The Boards observe that this diversity in practice is consistent with the feedback received on the proposals in the 2010 proposed Update on determining when control of a good or service transfers over time.
- BC112. The Boards envisage that the diversity in practice should be reduced by the proposed guidance in paragraphs 35 and 36 that clarifies when goods or services transfer over time. However, the Boards observe that the pattern of transfer may be different for different contracts because the pattern of transfer will depend on the relevant facts and circumstances of each contract. For example, some real estate

contracts may result in an asset that cannot (under the terms of the contract) be readily directed to another customer (that is, the entity's performance does not create an asset with an alternative use to the entity), and the contract requires the customer to pay for performance to date (thus meeting the criteria in paragraphs 35(b) and (b)(iii)). However, many of those real estate contracts that do not create an asset with an alternative use to the entity may not require the customer to pay for performance to date. Thus, for those contracts, an entity may reach a different conclusion on the pattern of transfer.

Measuring progress (paragraphs 38–48)

- BC113. When an entity determines that a separate performance obligation is satisfied over time, the entity must determine how much revenue to recognize in each reporting period by measuring its progress toward complete satisfaction of the performance obligation.
- BC114. There are various methods that an entity might use to measure its progress toward complete satisfaction of a performance obligation. Because of the breadth of the scope of the proposed guidance, the Boards decided that it would not be feasible to consider all possible methods and prescribe when an entity should use each method. Accordingly, an entity should use judgment when selecting an appropriate method of measuring progress. That does not mean that an entity has a "free choice." The proposed guidance states that an entity should select a method of measuring progress that is consistent with the clearly stated objective of depicting the transfer of goods or services to the customer (that is, the entity's performance).
- BC115. Furthermore, an entity should apply the selected method consistently for that performance obligation and also across contracts that have performance obligations with similar characteristics. The Boards decided that an entity should not use different methods to measure its performance in satisfying the same or similar performance obligations because that could reduce comparability. Moreover, an entity would effectively bypass the guidance for identifying separate performance obligations and allocating the transaction price to those performance obligations on the basis of standalone selling prices if the entity were to use more than one method to measure its performance in fulfilling a performance obligation. That is because the entity would need to identify subcomponents of a performance obligation to which the different measures of performance relate and to allocate a portion of the transaction price to those subcomponents on a basis other than standalone selling prices. A different basis of allocation would be required because, by virtue of those subcomponents not being distinct goods or services, those subcomponents would not be capable of being sold as standalone goods or services.

BC116. The proposals in paragraphs 38–48 carry forward some of the proposals in the 2010 proposed Update. However, in light of feedback received, the Boards have clarified and expanded that guidance as explained below.

Output methods (paragraphs 41–43)

BC117. Consistent with existing guidance, the Boards explained in the 2010 proposed Update that output methods often result in the most faithful depiction of the transfer of goods or services to a customer. Some respondents agreed with that proposal in concept but thought that the 2010 proposed Update did not sufficiently describe the advantages and disadvantages of output and input methods. In addition, some thought that the 2010 proposed Update was too biased toward output methods and asked the Boards to remove the stated preference for output methods.

BC118. In redeliberating the proposals, the Boards affirmed that, conceptually, an output measure is the most faithful depiction of an entity's performance because it directly measures the value of the goods or services transferred to the customer. The Boards noted that the description of output methods in the 2010 proposed Update implied that recognizing revenue using "units of delivery" and "contract milestone" methods would always be superior methods of recognizing revenue for performance obligations satisfied over time compared with input methods. However, the Boards observe that such methods may not always result in appropriate depictions of the entity's performance over time. For example, a "units of delivery" method may be an appropriate method for a long-term manufacturing contract of standard items that individually transfer an equal amount of value to the customer. However, a "units of delivery" method may not be appropriate if the contract provides both design and production services because in this case each item produced may not transfer an equal amount of value to the customer. Accordingly, in the proposed guidance, the Boards have clarified the description of an output measure and explained that "units of delivery" and "contract milestones" are examples of output measures.

BC119. The Boards have also clarified that, in some circumstances, another output method would be to recognize revenue at the amount of consideration to which the entity has a right to invoice. This method would be appropriate if the amount of consideration that the entity has a right to invoice corresponds directly with the value of each incremental good or service that the entity transfers to the customer (that is, the entity's performance to date). This may occur, for example, in a services contract in which an entity invoices a fixed amount for each hour of service provided.

BC120. The Boards also acknowledged that, in some circumstances, an output method can be unnecessarily costly for an entity to apply. Therefore, in those situations, it would be appropriate for an entity to select an input method to measure its progress provided that an input method is a reliable proxy of the outputs to the customer.

Input methods (paragraphs 44–46)

BC121. In some contracts, an entity promises to transfer both goods and services to the customer, and the customer takes control of the goods, which are a significant part of the performance obligation, at a different time from the services (for example, the customer obtains control of the goods before they are installed). If those goods and services are not distinct, then the entity would have a single performance obligation. Because there is diversity in practice about how to apply an input method to measure progress in such situations, the Boards decided to provide additional guidance.

BC122. The Boards observed that if the customer obtains control of the goods, then it would be inappropriate for the entity to continue to recognize the goods as inventory. Instead, the entity should recognize revenue for the transferred goods in accordance with the core principle of the proposed guidance. The Boards also observed that if the entity applies a cost-to-cost method of measuring progress, the entity might (absent clear requirements in the proposed guidance) include the cost of the goods in the cost-to-cost calculation and, hence, recognize a contract-wide profit margin for the transfer of the goods. The Boards thought that recognizing a contract-wide profit margin before the goods are installed could overstate the measure of the entity's performance. Alternatively, requiring an entity to estimate a margin that is different from the contract-wide margin could be complex and could effectively create a separate performance obligation for goods that are not distinct (thus bypassing the guidance for identifying separate performance obligations). Hence, the Boards decided that, in specified circumstances, an entity should recognize revenue for the transfer of the goods but only in an amount equal to the cost of those goods. In those circumstances, an entity would exclude the costs of the goods in the cost-to-cost calculation and recognize the margin on the transferred goods as the entity satisfies its single separate performance obligation.

Reasonable measures of progress (paragraphs 47 and 48)

BC123. The Boards clarified that when selecting a method to measure progress and, thus, determining when to recognize revenue, an entity should recognize revenue for its performance only if it can reasonably measure

its progress toward complete satisfaction of the performance obligation. However, in cases in which an entity cannot reasonably measure its progress but the entity expects to recover the costs incurred in satisfying the performance obligation, the Boards thought that the entity should recognize at least some amount of revenue to reflect the fact that it is making progress in satisfying the performance obligation. Therefore, in these cases, the Boards decided that an entity should recognize revenue for the satisfaction of the performance obligation only to the extent of the costs incurred. (That method is consistent with existing guidance on measuring progress in Subtopic 605-35 and IASs 11 and 18.) However, the Boards also decided that an entity would stop using that method when it can reasonably measure its progress toward complete satisfaction of the performance obligation or when the performance obligation becomes onerous.

Measurement of revenue (paragraphs 49–67)

- BC124. In their redeliberations, the Boards affirmed the proposal in the 2010 proposed Update to measure revenue based on an allocated transaction price approach. Under that approach, an entity would allocate the transaction price to each separate performance obligation at an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for satisfying each separate performance obligation. That allocation would determine the amount of revenue that an entity recognizes when (or as) it satisfies each performance obligation. Most respondents to the Discussion Paper and the 2010 proposed Update supported the allocated transaction price approach.
- BC125. The Boards considered, but rejected, an alternative measurement approach, which would have been to measure the remaining performance obligations directly at each reporting date. The Boards observed that this alternative would make accounting for the contract more complex. In addition, the Boards expected that it would provide little additional information to users of financial statements in many cases, either because the values of goods or services promised are not inherently volatile or because the effect of any volatility that might exist is limited because an entity transfers the goods or services to the customer over a relatively short time. Paragraphs BC26–BC28 include additional discussion on rejected measurement approaches.
- BC126. The allocated transaction price approach generally would require an entity to follow three main steps to determine the amount of revenue that can be recognized for satisfied performance obligations. Those steps are as follows:

- (a) Determine the transaction price for the contract
- (b) Allocate the transaction price to separate performance obligations
- (c) Recognize revenue at the amount allocated to the satisfied performance obligation. When the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue recognized should not exceed the amount to which the entity is reasonably assured to be entitled.

Determining the transaction price (paragraphs 50–67)

- BC127. Determining the transaction price is an important step in the revenue recognition model because the transaction price is the amount that an entity allocates to the separate performance obligations in a contract (that is, for a contract with more than one performance obligation). The transaction price is also an input to the onerous test (see paragraphs BC204–BC216).
- BC128. The Boards decided to define the transaction price as the amount of consideration that an entity expects to be entitled to receive in exchange for transferring goods or services. Therefore, the objective in determining the transaction price at each reporting date is to predict the total amount of consideration that the entity will be entitled to receive from the contract.
- BC129. In light of feedback on the 2010 proposed Update, the Boards clarified that the transaction price would include only amounts (including variable amounts) to which the entity has rights under the present contract. For example, the transaction price does not include estimates of consideration from (a) the future exercise of options for additional goods or services or (b) future change orders. Until the customer exercises the option or agrees to the change order, the entity does not have a right to consideration. Additionally, the Boards observed that in some industries (for example, the healthcare industry), there may be a difference between the contractually stated price for a good or service (for example, a list price) and the amount of consideration to which the entity expects to be entitled in accordance with its customary business practice of accepting a reduced amount of consideration as payment in full from customers (or a class of customers).
- BC130. Determining the transaction price when a customer promises to pay a fixed amount of cash consideration will be simple. However, determining the transaction price may be more difficult in the following cases:
- (a) The promised amount of consideration is variable (paragraphs BC131–BC142).

- (b) The contract has a financing component that is significant to the contract (that is, time value of money, paragraphs BC143–BC156).
- (c) The promised amount of consideration is in a form other than cash (that is, noncash consideration, paragraphs BC157–BC158).
- (d) There is consideration payable to the customer (paragraphs BC159–BC162).

Variable consideration (paragraphs 53–57)

- BC131. The 2010 proposed Update proposed that when the consideration in a contract is variable, an entity should measure the transaction price (at its expected value) using a probability weighted method. A probability weighted method reflects the full range of possible consideration amounts, weighted by their respective probabilities.
- BC132. Many respondents to the 2010 proposed Update disagreed with measuring the transaction price using a probability weighted method because they thought it would:
- (a) Be complex and costly to apply.
 - (b) Not generate meaningful results in all circumstances because, for example, it could result in an entity determining the transaction price at an amount of consideration that the entity could never obtain under the contract.
- BC133. Some respondents suggested that the Boards not specify a measurement model and instead require that the transaction price be determined using “management’s best estimate.” Many thought this would provide management with the flexibility to make an estimate on the basis of its experience and available information, without the documentation that would be required when a measurement model is specified.
- BC134. In their redeliberations, the Boards first affirmed their decision in the 2010 proposed Update to specify an objective and appropriate measurement method(s) for estimating the transaction price. This is because specifying an objective and measurement methods would provide the necessary framework to ensure rigor in the process of estimation. Furthermore, without such a framework, the measurement of revenue might not be understandable to users and might lack comparability between entities.
- BC135. However, the Boards then reconsidered the measurement model in the proposed guidance. They noted that a probability weighted method reflects all of the uncertainties existing in the transaction price at the reporting date. Therefore, it best reflects the conditions that are present

at each reporting date. For instance, it reflects the possibility of receiving a greater amount of consideration as well as the risk of receiving a lesser amount. However, in redeliberations, the Boards observed that users are most interested in knowing the total amount of consideration that ultimately will be realized from the contract. Therefore, the Boards decided that for the estimate of the transaction price to be meaningful at each reporting date, it should be an amount that the entity expects to better predict the amount of consideration to which it will be entitled.

- BC136. The Boards observed that, in some cases, a probability weighted estimate (that is, an expected value) is predictive of the amount of consideration to which an entity will be entitled. For example, that is likely to be the case if the entity has a large number of contracts with similar characteristics. However, the Boards agreed with respondents that an expected value may not always be predictive of the consideration to which an entity will be entitled. For example, if the entity is certain to receive one of only two possible consideration amounts, the expected value would not be a possible outcome in accordance with the contract. The Boards decided that in those cases, another method, the most likely method, would be necessary to estimate the transaction price. That is because the most likely method identifies the individual amount of consideration in the range of possible consideration amounts that is more likely to occur than any other individual outcome.
- BC137. Therefore, the Boards decided to specify that an entity should estimate either the expected value or most likely amount to estimate the transaction price, depending on which method the entity expects will better predict the amount of consideration to which the entity will be entitled.
- BC138. Although in theory, an entity using the most likely method must consider all the possible outcomes to identify the most likely one, in practice, there is no need to quantify the less probable outcomes. Similarly, in practice, estimating the expected value using a probability weighted method does not require an entity to consider all possible outcomes using complex models and techniques, even if an entity has extensive data and can identify many outcomes. In many cases, a limited number of discrete outcomes and probabilities can often provide a reasonable estimate of the distribution of possible outcomes. Therefore, the Boards decided that neither of the two approaches should be too costly or complex to apply.

Subsequent changes in the transaction price

- BC139. After contract inception, an entity revises its expectations about the amount of consideration to which it expects to be entitled as uncertainties are resolved or as new information about remaining uncertainties becomes available. To depict conditions that exist at each reporting date (and changes in conditions during the reporting period), the Boards decided that an entity should update its estimate of the transaction price throughout the contract. The Boards believe that reflecting current assessments of the amount of consideration to which the entity expects to be entitled would provide more useful information to users than retaining the initial estimates, especially for long-term contracts that are subject to significant changes in conditions during the life of the contract.
- BC140. The Boards considered whether, if the transaction price changes during a contract, an entity should:
- (a) Recognize those changes in profit or loss when those changes occur.
 - (b) Allocate those changes to performance obligations.
- BC141. The Boards rejected the alternative of recognizing the entire amount of a change in the estimate of the transaction price in profit or loss when that change occurs. In the Boards' view, that alternative could result in a pattern of revenue recognition that does not faithfully depict the pattern of the transfer of goods or services. Moreover, recognizing revenue immediately (and entirely) for a change in the estimate of the transaction price would be prone to abuse in practice. The Boards considered whether changes in the estimate of the transaction price could be presented as a gain or loss separately from revenue, thus preserving the pattern of revenue recognition. However, the Boards rejected that alternative because the total amount of revenue recognized for the contract would not equal the amount of consideration to which the entity was entitled under the contract.
- BC142. Instead, the Boards decided that an entity should allocate a change in the transaction price to all the performance obligations in the contract, subject to the conditions in paragraph 76 of the proposed guidance (discussed further in paragraphs BC186–BC189 and BC192). That is because the cumulative revenue recognized would then depict the revenue that the entity would have recognized if, at contract inception, it had had the information that was available at the subsequent reporting date. Consequently, the transaction price that is allocated to performance obligations that already have been satisfied would be recognized as revenue (or as a reduction to revenue) immediately.

Time value of money (paragraphs 58–62)

- BC143. Some contracts with customers include a financing component. The financing component may be explicitly identified in the contract or may be implied by the payment terms of the contract.
- BC144. Paragraph 58 of the proposed guidance specifies that an entity should account for the effects of the time value of money in a contract with a customer only if that contract includes a financing component that is significant to the contract. A contract has a financing component if the promised amount of consideration differs from the cash-selling price of the promised goods or services. In that case, the transaction price would be calculated as the nominal amount of customer consideration adjusted for the effects of the time value of money. The transaction price would be allocated to the performance obligations in the contract and, when a performance obligation is satisfied, the amount of revenue recognized would be the amount of the transaction price adjusted for the financing—in effect, the “cash selling price” of the underlying good or service at the time the good or service is transferred. The Boards noted that for some types of goods or services, such as prepaid phone cards and customer loyalty points, the customer will pay for those goods or services in advance, and the transfer of those goods or services to the customer is at the discretion of the customer. Consequently, in those cases, the Boards expect that those contracts would not include a financing component that is significant because, on an individual contract basis, the entity does not know when the goods or services will transfer to the customer.
- BC145. The Boards decided that an entity should account for the effects of the time value of money if a contract has a financing component that is significant for the following reasons:
- (a) Entities are not indifferent to the timing of the cash flows in a contract. Therefore, reflecting the time value of money portrays an important economic feature of the contract. A contract in which the customer pays for a good or service when that good or service is transferred to the customer is different from a contract in which the customer pays significantly before or after the good or service is transferred.
 - (b) Not recognizing the financing component could misrepresent the profit of a contract. For example, if a customer pays in arrears, ignoring the financing component of the contract would result in full profit recognition on the transfer of the good or service, despite the ongoing cost to the entity of providing financing to the customer.

- (c) Contracts with explicitly identified financing components would be accounted for consistently with contracts in which the financing component is implicit in the contract price.

BC146. For many contracts, an entity would not need to adjust the amount of customer consideration because the effects of the time value of money would not materially change the amount of revenue that should be recognized in relation to a contract with a customer. In other words, for those contracts, the financing component would not be significant. During their redeliberations, the Boards clarified that an entity would only need to consider the *significance* of a financing component at a contract level, rather than whether the financing is *material* at a portfolio level. The Boards decided that it would be unduly burdensome to require an entity to account for a financing component if the effects of the time value of money are not material to the individual contract but the combined time value of money effect for a portfolio of similar contracts would be material to the entity as a whole.

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

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

BC148. Some existing standards require an entity to recognize the effects of financing only if the time period exceeds a specified period, often one year. For example, paragraph 835-30-15-3 excludes those “transactions with customers or suppliers in the normal course of business that are due in customary trade terms not exceeding approximately one year.” The Boards decided to include similar relief from the requirement to account for a financing component that is significant to the contract. The Boards noted that the relief could produce arbitrary outcomes in some cases because the time value of money could be material for short-term contracts with high implicit interest rates and, conversely, may be immaterial for long-term contracts with low implicit interest rates. However, the Boards were persuaded to exempt entities from accounting for the effects of the time value of money on contracts with an expected duration of one year or less for the following reasons:

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

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

- (a) Represent a change from existing practices in which an entity typically does not recognize the time value of money implicit in advance payments.
- (b) “Gross up” revenue (for example, if the discount rate implicit in the contract resulted in the accretion of interest of \$21 over 2 years, revenue would be recognized at the amount of the \$121 rather than the \$100 paid in advance).

- (c) Not reflect the economics of the arrangement when the customer pays in advance for reasons other than financing (for example, the customer is a credit risk or is compensating the entity for incurring upfront contract costs).

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

Discount rate

BC151. The Boards considered whether the discount rate used to reflect the financing should be the risk-free rate or a risk-adjusted rate. A risk-free rate would be observable and simple to apply, and it would avoid the costs of determining a rate specific to each contract. However, the Boards decided that using the risk-free rate would not result in useful information because the resulting interest rate would not reflect the characteristics of the parties to the contract. In addition, the Boards noted that it would not necessarily be appropriate to use any rate explicitly specified in the contract because the entity might offer “cheap” financing as a marketing incentive and, hence, using that rate would not result in an appropriate recognition of profit over the life of the contract. Therefore, the Boards decided that an entity should use the rate that would be used in a financing transaction between the entity and its customer that did not involve the provision of goods or services, because that rate would reflect the characteristics of the party receiving financing in the contract. That rate also would reflect the customer’s creditworthiness, among other risks.

BC152. Some respondents to the 2010 proposed Update mentioned that determining the discount rate that would be used in a separate financing between an entity and the customer would be difficult and costly because most entities within the scope of the revenue standard do not enter into separate financing transactions with their customers. In addition, it would be impractical for entities with large volumes of customer contracts to determine a discount rate specifically for each individual customer.

BC153. In many cases, the Boards expect that those concerns would be addressed because the one-year exemption would apply. For those remaining contracts in which the entity is required to account separately for the financing component, the Boards expect that the entity and the customer would typically negotiate the contractual payment terms separately after considering factors such as inflation rates and the

customer's credit risk. Hence, an entity should have access to sufficient information to determine the discount rate that would be used in a separate financing between an entity and the customer.

Reevaluation of the effects of the time value of money

BC154. The 2010 proposed Update did not specify whether an entity should reevaluate the effects of the time value of money after the initial measurement of the transaction price. However, some respondents questioned whether an entity would be required to revise that measurement for a change in circumstances.

BC155. The Boards clarified that an entity should not update the discount rate for a change in circumstances because they decided that an entity should reflect in the measurement of the transaction price only the discount rate that is implicit in the contract at contract inception. They also observed that it would be impractical for an entity to update the transaction price for changes in the assessment of the discount rate. However, the Boards noted that an entity would reevaluate the effects of the time value of money when there is a change in the estimated timing of the transfer of goods or services to the customer.

Presentation of the effects of the time value of money

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

Noncash consideration (paragraphs 63 and 64)

BC157. When an entity receives cash from a customer upon delivery of a good or service, the transaction price and, hence, the amount of revenue, is the amount of cash received—that is, the value of the inbound asset. To be consistent with that approach when the customer pays noncash consideration (for example, goods or services), the Boards decided that the entity also should measure noncash consideration (or promises of noncash consideration) at fair value.

BC158. The Boards decided that if an entity cannot reasonably estimate the fair value of the noncash consideration, it should measure the promised consideration indirectly by reference to the selling price of the goods or

services promised in exchange for the consideration. That approach is consistent both with requirements in some existing revenue standards (for example, IAS 18) and with requirements for other situations in which the fair value of the assets surrendered in exchange for assets received may be estimated more reliably (for instance, IFRS 2, *Share-based Payment*, and Section 505-50-30 on the initial measurement of equity-based payments to nonemployees state that if the fair value of the goods or services received cannot be estimated reliably, then the entity measures them indirectly by reference to the fair value of the granted equity instrument).

Consideration payable to the customer (paragraphs 65–67)

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

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

Collectibility (paragraphs 68 and 69)

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

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

- (a) The recognition of revenue (that is, whether an entity recognizes revenue when a good or service is transferred)
- (b) The amount of revenue (that is, how much revenue an entity recognizes when a good or service is transferred).

BC165. The Boards' proposal on collectibility was one of the topics on which respondents to the 2010 proposed Update most commented. Although some respondents agreed with the concept of the transaction price reflecting the customer's credit risk, nearly all respondents (including preparers, users, and securities regulators) expressed concerns about applying that concept in practice. After considering that feedback, the

Boards decided not to adopt that proposal in the 2010 proposed Update. Instead, the Boards propose the following:

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

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

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

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

A separate recognition threshold

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

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

- (a) The contract with a customer should have commercial substance (as discussed in paragraph BC34).

- (b) Any impairment losses should be presented as a separate line item adjacent to the revenue line so that those losses on contracts with customers can be easily compared with the revenue recognized (as discussed in paragraphs BC171–BC173).

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

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

Presentation of the effects of a customer’s credit risk

BC171. The Boards propose that an entity should present any impairment losses from contracts with customers adjacent to the revenue line in profit or loss (subject to the usual materiality considerations for line-item disclosure). The Boards noted that their decision on presentation typically only changes the location of the line item for impairment losses arising from contracts with customers. The proposed guidance does not include any changes to the recognition and measurement of impairment losses of financial assets, such as trade receivables. Instead, an entity would recognize and measure the impairment loss in accordance with Topic 310 or IAS 39, *Financial Instruments: Recognition and Measurement* (or IFRS 9, *Financial Instruments*, if the entity has adopted IFRS 9). (In addition, the Boards have a separate project that is currently considering improvements to the impairment models in those standards.) Because impairment is a measurement issue that arises after initial recognition of an asset, the Boards decided that the proposed guidance also should specify the accounting for any difference between the amount of revenue that has been recognized and the corresponding initial measurement of the receivable. The Boards decided that any loss that arises on initial recognition of the receivable should be presented adjacent to the revenue line in profit or loss similarly with any impairment losses. The Boards expect that an entity typically would not recognize a loss on initial recognition because the receivable normally would initially be measured at the original invoice amount if the contract with a customer does not include a financing component that is significant.

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

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

- BC174. The effect of the Boards' decision on the time value of money (see paragraphs BC143–BC156) is that a contract with a customer that has a financing component that is significant to the contract would be bifurcated into a revenue component (for the notional cash sales price) and a loan component (for the effect of the deferred payment terms). The revenue component would be within the scope of the revenue standard, and the loan component would be within the scope of the financial instruments standards. Consequently, bifurcating the contract means that the accounting for a trade receivable arising from a contract with a customer that has a financing component that is significant to the contract should be comparable to the accounting for a loan with the same features. Consider the following example: Customer A purchases a good on credit and must pay \$1,000 in 3 years. The present value of this trade receivable is \$751. Now consider Customer B who borrows \$751 from a bank with a promise to pay \$1,000 in 3 years. Customer B

uses the loan to purchase the same good as Customer A. Economically, these transactions are the same but, absent the proposed guidance, the form of the transaction would determine whether the financing component would be accounted for as a trade receivable or as a loan. For this reason, paragraph 58 of the proposed guidance would require a contract (with a financing component that is significant to the contract) to be bifurcated, which would result in the same accounting for the financing elements of both transactions.

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

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

BC176. In the 2010 proposed Update, the Boards proposed that an entity should allocate the transaction price to all separate performance obligations in proportion to the standalone selling price of the good or service underlying each of those performance obligations at contract inception (that is, on a relative standalone selling price basis). They decided that an allocation based on standalone selling prices would faithfully depict the different margins that may apply to promised goods or services.

BC177. Most respondents to the 2010 proposed Update agreed with the proposal to allocate the transaction price on a relative standalone selling price basis. In addition, the 2010 proposed Update was broadly consistent with recent changes to U.S. GAAP (Update 2009-13) to account for multiple-deliverable revenue arrangements. However, respondents expressed concerns about the following topics:

- (a) Estimating the standalone selling price
- (b) Allocating discounts and contingent consideration.

Estimating standalone selling prices (paragraph 73)

- BC178. Consistent with the 2010 proposed Update, the proposed guidance specifies that if an entity does not have an observable price from selling a good or service separately, the entity should estimate the standalone selling price.
- BC179. The Boards affirmed the proposal in the 2010 proposed Update to indicate suitable estimation methods in paragraph 73 of the proposed guidance. The Boards also affirmed that they do not intend to preclude or prescribe any particular method for estimating a standalone selling price so long as the estimate is a faithful representation of the price at which the entity would sell the distinct good or service if it were sold separately to the customer. However, the Boards clarified that the method used by the entity to estimate a standalone selling price should maximize the use of observable inputs and should be applied consistently to estimate the standalone selling price of other goods or services with similar characteristics.
- BC180. The Boards observed that many entities may already have robust processes for determining standalone selling prices on the basis of reasonably available data points and the effects of market considerations and entity-specific factors. However, other entities may need to develop processes for estimating selling prices of goods or services that are typically not sold separately. The Boards decided that when developing those processes, an entity should consider all reasonably available information on the basis of the specific facts and circumstances. That information might include the following:
- (a) Reasonably available data points (for example, a standalone selling price of the good or service, the costs incurred to manufacture or provide the good or service, related profit margins, published price listings, third-party or industry pricing, and the pricing of other goods or services in the same contract)
 - (b) Market conditions (for example, supply and demand for the good or service in the market, competition, constraints, and trends)
 - (c) Entity-specific factors (for example, business pricing strategy and practices)
 - (d) Information about the customer or class of customer (for example, type of customer, geography, and distribution channel).

Residual approach

- BC181. In the 2010 proposed Update, the Boards proposed that the residual method should not be used to allocate the transaction price to separate performance obligations. However, in the accompanying basis for conclusions, the Boards noted that a residual (or reverse residual)

approach might be a suitable technique for estimating a standalone selling price if there is a directly observable price for one performance obligation but not the other. Under the residual approach, an entity would determine a standalone selling price of a good or service on the basis of the difference between the total transaction price and the standalone selling prices of other goods or services in the contract.

- BC182. Respondents to the 2010 proposed Update generally agreed that, in some circumstances, it might be appropriate to use a residual approach to estimate a selling price. However, those respondents thought that the proposed guidance should clarify how and when an entity could use the residual approach as an estimation method. Therefore, paragraph 73(c) of this proposed Update specifies the circumstances in which a residual approach would be a suitable method to estimate a standalone selling price. In specifying those circumstances, the Boards were particularly mindful of the challenges in determining standalone selling prices in contracts for intellectual property and other intangible products, in which the pricing can be highly variable because there is little or no incremental cost to the entity in providing those goods or services to a customer. In those circumstances, the most reliable way of determining the standalone selling price in the contract will often be to use a residual approach. For the same reason, the Boards noted that the residual approach might be appropriate in situations in which an entity has not yet established the selling price for a good or service that has not previously been sold.

Specifying a hierarchy of evidence

- BC183. Most respondents agreed with the Boards' proposal in the 2010 proposed Update for not prescribing a hierarchy of evidence for estimating a standalone selling price. However, some respondents recommended that the Boards specify a hierarchy of evidence to determine the standalone selling price of a separate performance obligation similar to the following hierarchy in Subtopic 605-25:
- (a) If vendor-specific objective evidence of a selling price is available, it would be used to determine the selling price of a promised good or service.
 - (b) If vendor-specific objective evidence is not available, an entity would determine the selling price using third-party evidence, if available.
 - (c) If third-party evidence is not available, then an entity would use its best estimate of selling price.
- BC184. Those respondents indicated that specifying a hierarchy of evidence for determining standalone selling prices (and requiring disclosures using

that hierarchy) would enhance the quality and reliability of an entity's reported revenues.

BC185. The Boards observed that under the proposed guidance, an entity should use observable prices when a good or service is sold separately by the entity (similar to a vendor-specific objective evidence notion). It is only when a good or service is not sold separately that an entity would estimate selling prices. And, in that estimation process, an entity would still be required to maximize the use of observable inputs. The Boards observed that there is little distinction between third-party evidence and a best estimate of selling price in the above hierarchy in Subtopic 605-25. For instance, third-party evidence of a selling price might require adjustments to reflect differences either in (a) the good or service (because the third-party price could be for a similar, rather than identical, good or service) or (b) pricing strategies between the third party and the entity. Hence, the Boards affirmed their proposal in the 2010 proposed Update not to specify a hierarchy. Instead, the Boards decided that it was important to emphasize that an entity should maximize the use of observable inputs when developing estimates of standalone selling prices.

Allocating discounts and contingent consideration (paragraphs 74–76)

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

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

standalone selling price and the direct costs of the good or service underlying each separate performance obligation.

- BC187. Another consequence of allocating the transaction price on a relative standalone selling price basis is that any amount of the consideration that is contingent on a future event or circumstance is allocated to all the separate performance obligations in the contract. Some respondents to the 2010 proposed Update thought that this would not always faithfully depict the amount of consideration to which an entity is entitled on satisfying a particular performance obligation. Many suggested that such contingent amounts should be allocated only to the performance obligation(s) to which they relate.
- BC188. In redeliberating the proposals in the 2010 proposed Update, the Boards noted that the objective of the model is for an entity to recognize revenue in the amount of consideration to which the entity expects to be entitled from the customer in exchange for transferring goods or services. The relative standalone selling price basis allocation is simply a method to achieve that objective rather than the principle itself for allocating the transaction price.
- BC189. However, the Boards also note that allocating the transaction price on a relative standalone selling price basis brings rigor and discipline to the process of allocating the transaction price and, therefore, enhances comparability both within an entity and across entities. Therefore, the Boards decided that it should be the default method for allocating the transaction price. However, they agreed with respondents that it might not always result in a faithful depiction of the amount of consideration to which the entity expects to be entitled from the customer. Accordingly, in the proposed guidance, the Boards have specified when other methods should be used.

Allocating discounts (paragraphs 74 and 75)

- BC190. The 2010 proposed Update acknowledged that, in some cases, it would be inappropriate to allocate a discount to all the separate performance obligations in a contract. Hence, the 2010 proposed Update included a “contract segmentation” principle that would restrict the allocations of discounts on the basis of goods or services that are priced independently (discussed in paragraph BC49). Many respondents to the 2010 proposed Update agreed with the objective of the contract segmentation principle. However, most thought that the objective could be better met by incorporating the principle into the allocation process. Accordingly, the Boards have largely carried forward into the proposed guidance the notion that an entity should allocate a discount to one or more separate performance obligations, rather than to all the performance obligations, if the entity has observable sales prices for

parts of the contract that establish that the entire discount in the contract is attributable only to one or more separate performance obligations.

BC191. The Boards rejected the other alternatives suggested by respondents. The Boards decided that the transaction price is for the contract as a whole. Therefore, unless the price of some promised goods or services in the contract is largely independent of the price of other promised goods or services, any discount in the contract would be attributable to the contract as a whole and should be allocated proportionally to all the separate performance obligations in the contract. In addition, the Boards noted that the profit margin method would require an entity to estimate the costs to satisfy a performance obligation. Apart from creating additional complexity, the Boards were concerned that different treatments in the way costs are allocated to performance obligations could significantly affect how the transaction price is allocated.

Allocating contingent consideration (paragraph 76)

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

Contingent revenue cap

BC193. Some respondents to the 2010 proposed Update disagreed with the Boards' proposal that the transaction price should be allocated on a relative standalone selling price basis. Those respondents (primarily from the telecommunications and cable television industry) requested that, instead, the Boards carry forward the contingent revenue allocation guidance from Subtopic 605-25 (often described as the contingent revenue cap). (There is no equivalent guidance in IAS 18, although in practice the Boards understand that most telecommunications entities

that apply IFRSs account for their contracts in a similar manner as entities that apply U.S. GAAP.)

- BC194. The contingent revenue cap limits the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future (or meeting other specified performance conditions). For example, under that guidance, the amount of consideration that a telecommunications entity can allocate to a handset that is bundled with network services is limited to the amount that is not contingent on the delivery of network services in the future. Hence, when the handset is transferred to the customer, revenue is recognized at the amount that the customer paid for the handset at contract inception. The remaining contractual payments are recognized subsequently as revenue as the entity provides network services to the customer.
- BC195. Respondents from the telecommunications industry observed that without a contingent revenue cap, revenue would be recognized for delivering a handset in an amount that exceeds the amount of consideration paid for the handset. These respondents do not think this is appropriate because they would be entitled to collect the excess only when they provide the network services. Therefore, they reasoned that the contract asset that results from recognizing revenue for delivery of the handset does not meet the definition of an asset. Additionally, they suggested that without a contingent revenue cap, the proposed model would be complex and costly to apply because of the high volume of contracts that they have to manage and the various potential configurations of handsets and network service plans.
- BC196. However, the Boards affirmed their proposal in the 2010 proposed Update not to carry forward the contingent revenue cap for the following reasons:
- (a) Limiting the amount of consideration that can be allocated to a satisfied separate performance obligation is tantamount to cash-basis accounting and does not meet the core principle of the proposed guidance. That is because revenue recognized would not depict the amount of consideration to which the entity expects to be entitled for the delivered good or service. Consequently, the contingent revenue cap could result in economically similar contracts being accounted for differently.
 - (b) The contingent revenue cap can result in the recognition of losses when the contract is profitable. That would occur when the amount allocated to a satisfied performance obligation is constrained (potentially to zero) to an amount that is less than the expenses recognized for the costs of providing the good or service (unless those costs are deferred). However, costs

relating to a good or service already transferred to the customer would not give rise to an asset.

- (c) Recognizing a contract asset in the situation described in paragraph BC195 is appropriate because the entity clearly has a valuable contractual right as a result of satisfying a performance obligation and that right meets the definition of an asset. That right exists even if the entity does not have the present right to collect consideration from the customer. This is evidenced by the fact that if the entity were to transfer the remaining rights and performance obligations in the contract to a third party after it had delivered a handset, it would expect to be compensated for that past performance.
- (d) Applying the contingent cap more broadly than it is applied in existing standards could have far-reaching consequences. For example, in many services contracts (including construction contracts), it is appropriate to recognize revenue when services are provided even though the amount of consideration is contingent on the entity's future performance. Otherwise, the entity would not recognize any revenue until reaching a contract milestone or potentially until completion of the contract (which would not depict the transfer of goods or services to the customer).
- (e) Although the consequences on construction and other service contracts could be reduced by limiting the amount allocated to satisfied separate performance obligations (rather than limiting the amount allocated to a satisfied portion of a single performance obligation), the Boards decided that this would create an arbitrary distinction and put additional pressure on the criteria for identifying separate performance obligations.
- (f) For many contracts that currently are accounted for under the contingent revenue cap, the amount of consideration allocated to delivered items is not contingent because even if the customer cancels the contract, it would be obliged to pay for the delivered item(s). For example, in some contracts for the sale of a handset and network services, the contract either is not cancellable or, if it is, the customer is obliged to pay a termination fee that corresponds with the value of the handset delivered upfront (even if the entity chooses not to enforce payment of that fee).

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

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

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

the circumstances in which the amount of revenue should be constrained. The Boards acknowledge that the constraint is a qualitative threshold, rather than a quantitative threshold, and is not meant to include assessments of collectibility, which are considered separately (see paragraphs BC163–BC175).

Determining when the amount of revenue recognized is reasonably assured

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

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

in exchange for satisfying those performance obligations). To help an entity assess whether its experience predicts the amount of consideration, the Boards decided to specify the indicators in paragraph 82. Those indicators were derived in part from existing guidance in U.S. GAAP on estimating sales returns. Those indicators also were proposed in the 2010 proposed Update.

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

Onerous performance obligations (paragraphs 86–90)

- BC204. The proposed guidance specifies that an entity should recognize a liability for an onerous performance obligation that is satisfied over time and that the entity expects at contract inception to satisfy over a period of time greater than one year. The Boards decided that an onerous test is a necessary component of a revenue model in which the initial measurements of performance obligations are not routinely updated. The onerous test provides users with important information by, in effect, remeasuring performance obligations to reflect significant adverse changes in circumstances.

BC205. Some respondents agreed with the Boards that the proposed revenue model should include an onerous test. However, a few respondents stated that performance obligations should never be remeasured and that losses on a contract should emerge over time as the revenue is recognized. In addition, some stated that a liability for an onerous performance obligation represents an accrual of costs and, therefore, is not related to revenue recognition. The Boards disagreed with those views for the following reasons:

- (a) Both U.S. GAAP and IFRSs include an onerous test for some types of loss-making contracts (that is, the consideration to be received must equal or exceed the expected costs to satisfy the performance obligations). Not having such a test would be a major change to current practice for some types of contracts.
- (b) Including the onerous test in the proposed guidance would achieve greater convergence of U.S. GAAP and IFRSs on the margins reported from some contracts with customers.
- (c) Although the onerous test appears to be a liability recognition and measurement issue (because it results in the recognition of a separate liability that has no effect on the revenue recognition), conceptually, the onerous test is a (re)measurement issue, because there has been no new obligating event.
- (d) The onerous test can be viewed as the mirror image for liabilities of an asset impairment test (that is, a test to ensure that the amount of a performance obligation is not understated).

Unit of account

BC206. Many respondents disagreed with the proposal in the 2010 proposed Update to apply the onerous test to individual performance obligations. Those respondents observed that applying the onerous test to individual performance obligations may not always generate meaningful information, in particular, because the onerous test would often require the recognition of a loss at contract inception for loss-making performance obligations even though the contract as a whole is expected to be profitable. Other respondents explained that their contracts are priced and profitability is assessed at a unit of account higher than the contract (or the remaining performance obligations) and, therefore, the unit of account for applying the onerous test should also be higher to correspond with how the entity manages those contracts.

BC207. The Boards considered, but rejected, changing the unit of account for the onerous test because they thought that it would add complexity and be inconsistent with recognizing revenue at the performance obligation level. In addition, the Boards noted that specifying the contract as the unit of account could be arbitrary because the unit of account would depend on whether the entity provides its goods or services in one

contract or in more than one contract. Instead, the Boards decided to address respondents' concerns on the unit of account by modifying the scope of the onerous test.

Scope of the onerous test

- BC208. The Boards propose to limit the scope of the onerous test to performance obligations that are satisfied over time. Thus, a liability would be recognized when a performance obligation that is satisfied over time is determined to be onerous. As a practical expedient, the Boards propose that an entity would apply the onerous test only to performance obligations that an entity expects at contract inception will be satisfied over a period of time that is greater than one year. In the Boards' view, limiting the scope of the onerous test limits the risk of unintended consequences of applying the onerous test to some contracts. That is because the proposed scope is closest to the scope of existing revenue standards that specify an onerous test (that is, Subtopic 605-35 and IAS 11).
- BC209. In addition, limiting the scope of the onerous test would address some cost-benefit concerns because it would minimize the amount of additional effort needed for an entity to apply the test. When a performance obligation is satisfied over time, an entity already is required to measure progress toward complete satisfaction of that performance obligation, which typically would require the entity to evaluate whether the performance obligation is loss-making.
- BC210. The Boards noted that performance obligations excluded from the scope of the onerous test (that is, performance obligations satisfied at a point in time) typically have or result in the creation of related assets that would be subject to impairment testing in other standards. For example, existing standards on inventory already provide guidance on how an entity should test for impairment inventory that is subject to a sales contract. That guidance also may require an entity to recognize any loss from contracts to transfer goods to a customer at a point in time, even if the entity has not yet acquired those goods that would be recognized as inventory (see paragraph 330-10-35-17 and paragraph 31 of IAS 2, *Inventories*).

Identifying when a performance obligation is onerous

- BC211. In the 2010 proposed Update, the Boards proposed that an entity should identify a performance obligation as onerous when the expected costs to satisfy the performance obligation exceed the amount of the transaction price allocated to that performance obligation. The Boards observed that the main consequence of using this approach is that any margin in the measurement of the performance obligation would act as

a buffer to absorb adverse changes in the performance obligation. In other words, the amount of the performance obligation would remain unchanged until the entity expects that the satisfaction of the performance obligation would result in a loss.

BC212. In developing the 2010 proposed Update, the Boards considered, but rejected, requiring an entity to identify a performance obligation as onerous when the current price of the performance obligation (that is, costs plus a margin) exceeds the amount of the transaction price allocated to it. The Boards observed that this approach would potentially result in earlier recognition of the effects of adverse changes in circumstances because any margin in the measurement of the performance obligation would not be used as a buffer to absorb adverse changes. However, because this approach would include a margin in the trigger for identifying when a performance obligation is onerous, the Boards decided that it would increase the frequency of remeasurements. Consequently, it would increase complexity and more closely resemble an approach in which the performance obligations are remeasured at each reporting date, which is an approach that the Boards had previously rejected (as discussed in paragraph BC26).

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

Measurement basis

BC214. The Boards affirmed their proposal in the 2010 proposed Update that when a performance obligation is onerous, it should be remeasured on a basis that is consistent with the trigger for identifying when that performance obligation is onerous. Accordingly, they decided that an onerous performance obligation should be measured at the lowest cost of settling that obligation. Additionally, the Boards affirmed the proposal in the 2010 proposed Update that the costs that relate directly to satisfying the performance obligation should be the same as those defined in paragraph 92 of the proposed guidance. Absent specifying a

value or a price for the remeasurement, the Boards decided that this approach would provide a clear objective for which costs to include.

- BC215. In developing the 2010 proposed Update, the Boards considered, but rejected, requiring entities to include a margin in the remeasurement of an onerous performance obligation. The rationale for including a margin would be that a profit-oriented entity typically does not promise to transfer a good or service to a customer without a margin. However, the Boards noted that including a margin in the remeasurement would be a significant change to the guidance for loss-making contracts in existing standards (for example, Subtopic 605-35 and IAS 11) and would increase the complexity of remeasuring onerous performance obligations, particularly when observable prices do not exist. Furthermore, some think that it would be counterintuitive for an entity to recognize a profit when it satisfies an onerous performance obligation.

Presentation of the liability for onerous performance obligations

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

Contract costs (paragraphs 91–103)

Costs of fulfilling a contract (paragraphs 91–93)

- BC217. In the 2010 proposed Update, the Boards developed guidance for accounting for some costs to fulfill a contract. That guidance was developed in response to concerns that the proposals in the Discussion Paper focused on how an entity should recognize revenue in a contract without considering how an entity should account for the costs to fulfill a contract. Some respondents to the Discussion Paper, in particular those from the construction industry, said that guidance on profit margin recognition is as important as guidance on revenue recognition. Other respondents, mainly preparers who use U.S. GAAP, were concerned about the withdrawal of cost guidance that was developed specifically for their respective industries.

BC218. The proposed cost guidance in the 2010 proposed Update was intended to:

- (a) Fill the gap arising from the withdrawal of existing revenue standards—The proposed revenue standard would result in the withdrawal of some guidance on contract costs, in particular, the guidance in Subtopic 605-35 and IAS 11.
- (b) Improve current practice—The proposed guidance would provide clearer guidance on accounting for some costs to fulfill a contract (for example, setup costs for services) and would result in an entity no longer having to rely on, or analogize to, requirements that were not developed specifically for contracts with customers. For instance, in accounting for setup costs, an entity applying U.S. GAAP might analogize to the guidance on the deferral of direct loan origination costs in paragraph 310-20-25-2. An entity applying IFRSs might evaluate those costs in accordance with IAS 38, *Intangible Assets*. Specifying clear requirements also would result in greater consistency in practice.
- (c) Promote convergence in accounting for contract costs—More costs would be accounted for similarly under U.S. GAAP and IFRSs (although total consistency in accounting for costs to fulfill a contract will not be achieved until the Boards align their respective standards on inventories; property, plant, and equipment; intangible assets; and impairment of assets).

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

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

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

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

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

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

- (a) Other standards require some of the costs of obtaining a contract to be included in the carrying amount of an asset on initial recognition.
- (b) The proposals in the 2010 proposed Update were inconsistent with the tentative conclusions in the Boards' leases and insurance contracts projects.

BC224. During redeliberations, the Boards decided that, in some cases, it might be misleading for an entity to recognize all the costs of obtaining a contract as expenses when incurred. For example, the Boards observed that recognizing the full amount of a sales commission as an expense at inception of a long-term service contract (when that sales commission is reflected in the pricing of that contract and expected to be recovered) would fail to acknowledge the existence of an asset.

BC225. Therefore, the Boards decided that an entity should recognize an asset from the costs of obtaining a contract but present the asset separately

from the contract asset or liability. To limit the acquisition costs to those that can be clearly identified as relating specifically to, and recoverable under, a contract, the Boards propose that only the incremental costs of obtaining a contract should be included in the measurement of the asset. The Boards decided that determining whether other costs relate to a contract can be more subjective. The proposed approach also is consistent with most existing revenue recognition practices (for example, for investment management services as described in the illustrative examples that accompany IAS 18).

- BC226. The Boards acknowledge that, in some cases, the costs to an entity of recognizing an asset from incremental acquisition costs might exceed the financial reporting benefits. Therefore, as a practical expedient, they decided to allow an entity to recognize those costs as expenses when incurred for contracts in which the amortization period for the asset that the entity otherwise would have recognized is one year or less.

Amortization and impairment (paragraphs 98–103)

- BC227. The 2010 proposed Update proposed that an entity should amortize the asset recognized from fulfillment costs in accordance with the pattern of transfer of goods or services to which the asset relates. Respondents to the 2010 proposed Update generally supported that proposal but asked the Boards to clarify whether those goods or services might relate to future contracts. Hence, the Boards clarified in this proposed Update that in amortizing the asset in accordance with the transfer of goods or services to which the asset relates, those goods or services could be provided under an anticipated contract that the entity can identify specifically. That conclusion is consistent with the notion of amortizing an asset over its useful life and with existing requirements.
- BC228. The Boards considered testing for impairment a recognized asset arising from fulfillment costs using one of the existing impairment tests in their respective standards (for example, Section 330-10-35 on subsequent measurement of inventory, IAS 2, Section 360-10-35 on the impairment of long-lived assets, and IAS 36, *Impairment of Assets*). However, the Boards decided that to be consistent with the measurement approach of the proposed guidance, the impairment test should be based on comparing the carrying amount of the asset with the remaining amount of consideration to which an entity expects to be entitled in exchange for the goods or services to which the asset relates less the remaining costs of providing those goods or services—that is, typically the amount of the transaction price allocated to the remaining performance obligations in the contract less the remaining costs to fulfill. That also would be consistent with the test for identifying whether performance obligations are onerous (as discussed in paragraphs BC211–BC213).

BC229. In light of feedback on the 2010 proposed Update, this proposed Update specifies that when the reasons for an impairment cease to exist, that impairment should not be reversed under U.S. GAAP but should be reversed under IFRSs. The Boards acknowledged that this would result in entities accounting differently for those contract costs under U.S. GAAP and IFRSs. However, the Boards decided that because the reasons for an impairment of an asset recognized in accordance with paragraph 91 or 94 could also result in impairments of other assets, it was important for the proposed guidance to be consistent with their respective impairment models for other types of assets, which have different guidance for the reversal of impairments.

Learning curve

BC230. A learning curve is the effect of efficiencies realized over time when an entity's costs of performing a task (or producing a unit) decline in relation to how many times the entity performs that task (or produces that unit). The phenomenon of a "learning curve" can exist independently of a contract with a customer. For example, a typical manufacturer that produces units for inventory would become more efficient in its production process over time. Some respondents to the 2010 proposed Update questioned how to apply the proposals to account for the effects of learning costs in a contract with a customer.

BC231. The Boards noted that the proposals in the 2010 proposed Update already addressed the accounting for the effects of learning costs in the following situations:

- (a) An entity has a single performance obligation to deliver a specified number of units.
- (b) The performance obligation is satisfied over time.

BC232. In those situations, an entity would recognize revenue by selecting a method of measuring progress that depicts the transfer over time of the good or service to the customer. An entity likely would select a method (for example, cost-to-cost) that would result in the entity recognizing more revenue and expense for the early units produced relative to the later units. That effect would be appropriate because of the greater value of the entity's performance in the early part of the contract. If an entity were to sell only one unit, it would charge the customer a higher price for that unit than the average unit price when the customer purchases more than one unit.

BC233. In other situations, an entity may promise to deliver a specified number of units in a contract, but that promise does not give rise to a single performance obligation that is satisfied over time. In those situations, the Boards decided that an entity should apply the guidance of other standards (for example, inventory) for the following reasons:

- (a) If an entity incurs costs to fulfill a contract but does not satisfy a performance obligation over time, then the entity likely would be creating an asset that would be in the scope of other standards. For example, the costs of producing tangible units would accumulate as inventory, and the entity would select an appropriate method of measuring that inventory (for example, on the basis of average costs). In such cases, the Boards decided that an entity should not account for the learning curve differently depending on whether a contract exists.
- (b) The type of contract described in this paragraph is not the type of contract contemplated by Subtopic 605-35 and IAS 11, which are the standards typically used by respondents who questioned the accounting for learning curve effects in accordance with the proposed guidance.

BC234. The Boards, however, acknowledged the diversity in practice when accounting (in accordance with other standards) for the costs of products produced under long-term production programs. They agreed to consider adding a project to their agenda at a future time.

Presentation (paragraphs 104–108)

BC235. The Boards propose that the remaining rights and performance obligations in a contract form a single unit of account and should be accounted for, and presented, on a net basis as either a contract liability or a contract asset. The Boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer is dependent on the entity’s performance and, similarly, the entity will perform only as long as the customer continues to pay. They decided that these interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.

BC236. The Boards considered whether the rights and performance obligations in contracts that are subject to the legal remedy of specific performance should be presented on a gross basis, that is, as separate assets and liabilities. The Boards observed that in the event of a breach, such contracts require the entity and the customer to perform as specified in the contract. Therefore, unlike most contracts that can be settled net, specific performance contracts generally would result in a two-way flow of resources between the customer and the entity. The contracts are akin to those financial contracts that are settled by physical delivery rather than by a net cash payment and for which the units of account are the individual assets and liabilities arising from the contractual rights and obligations.

- BC237. However, the Boards decided against making any exception for specific performance contracts. That is because the remedy of specific performance is relatively rare and is not available in all jurisdictions. In addition, it is only one of a number of possible remedies that could be awarded by a court if legal action were taken for breach of contract. Therefore, basing the accounting on a determination of what would happen in that event would both be counterintuitive (because entities do not enter into contracts with the expectation that they will be breached) and difficult (because an entity would need to determine at contract inception what remedy would be awarded by the court if litigation were to take place in the future).
- BC238. The Boards decided that the proposed guidance should not specify whether an entity should be required to present its contract assets and contract liabilities as separate line items in the statement of financial position. Instead, an entity should apply the general principles for the presentation of financial statements to determine whether to present contract assets and contract liabilities separately in the statement of financial position. For example, IAS 1, *Presentation of Financial Statements*, requires an entity to present separately each material class of similar items and items of a dissimilar nature or function unless they are immaterial. The Boards noted that in some industries, an entity typically provides additional detail about its contract assets and contract liabilities either in the financial statements or in the notes. For instance, the entity may use different labels to describe those assets or liabilities or may recognize them in more than one line item. Because that additional detail is often useful to users of those financial statements, the Boards decided that an entity could use different descriptions of *contract assets*, *contract liabilities*, and *receivables* and could use additional line items to present those assets and liabilities if the entity also provides sufficient information for users to be able to distinguish those assets and liabilities. The Boards noted that, regardless of how an entity presents its contract assets and contract liabilities in the statement of financial position, the entity is required to disclose those contract assets and contract liabilities as part of the reconciliation in paragraph 117.

Relationship between contract assets and receivables

- BC239. When an entity performs first by satisfying a performance obligation before a customer performs by paying the consideration, the entity has a contract asset—a right to consideration from the customer in exchange for goods or services transferred to the customer.
- BC240. In many cases, that contract asset is an unconditional right to consideration—a receivable—because nothing other than the passage of time makes payment of the consideration due. The Boards decided

that there was no need for the revenue recognition standard to address the accounting for receivables in addition to revenue recognition. Issues such as the subsequent measurement (or impairment) of receivables and disclosures relating to those assets are already addressed in U.S. GAAP and IFRSs.

- BC241. Therefore, the Boards decided that once an entity has an unconditional right to consideration, the entity should present that right as a receivable separately from the contract asset and account for it in accordance with existing guidance. Consequently, contract assets would be recognized in accordance with the proposed guidance when an entity has satisfied a performance obligation but does not yet have an unconditional right to consideration, for example, because it first needs to satisfy another performance obligation in the contract.
- BC242. In many cases, an unconditional right to consideration arises when the entity satisfies the performance obligation and invoices the customer. For example, a payment for goods or services is typically due and an invoice is issued when the entity has transferred the goods or services to the customer. However, the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration. For instance, the entity may have an unconditional right to consideration before it invoices (unbilled receivable) if there is nothing but the passage of time before it is able to issue an invoice. In addition, in some cases, an entity can have an unconditional right to consideration before it has satisfied a performance obligation. For example, an entity may enter into a noncancellable contract that requires the customer to pay the consideration a month before the entity provides goods or services. On the date when payment is due, the entity has an unconditional right to consideration. (However, in such cases, the entity would recognize revenue only when it has transferred the goods or services.)

Disclosure (paragraphs 109–129)

- BC243. Some of the main criticisms made by regulators and users of existing revenue requirements are that the disclosures are inadequate and lack cohesion with the disclosure of other items in the financial statements. For example, many users complain that entities present revenue in isolation so that users cannot relate revenue to the entity's financial position.
- BC244. In light of those deficiencies, the Boards decided to propose a comprehensive and coherent set of disclosures to help users of financial statements understand and analyze how contracts with customers affect an entity's financial statements. The Boards decided that a

comprehensive and coherent set of revenue disclosures should include the following:

- (a) An explanation of the composition of revenue recognized in a reporting period
- (b) A reconciliation of changes in contract asset and liability balances from period to period
- (c) Information about performance obligations and onerous contracts that the entity has with customers
- (d) Information about acquisition and fulfillment costs
- (e) An explanation of the judgments, and changes in the judgments, used in recognizing revenue.

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

Disclosure objective (paragraphs 109–112)

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

Materiality

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

BC248. After consulting further with some users and preparers, the Boards decided that the revised proposed disclosures achieve an appropriate balance between users' needs and preparation concerns. The Boards disagreed with concerns that the proposed disclosures are excessive. Although the volume of disclosure would increase compared to existing revenue disclosure requirements, the Boards consider that the increase in disclosure is necessary for an improvement to existing disclosure practices and the usefulness of financial reporting, which, as noted in paragraph BC243, have substantial shortcomings. Furthermore, the Boards think that at least some of the concerns about excessive disclosure are based on inferences relating to the length of the list of proposed disclosures. That list of disclosures is necessary because the revenue standard would apply to entities operating in a wide array of industries and, as such, needs to specify revenue disclosures that might be relevant for some entities or industries but not for others. Consequently, those disclosures should not be viewed as a checklist of minimum disclosures. One of the reasons the Boards included paragraph 110 in the proposed guidance is to clarify that, consistent with existing guidance in U.S. GAAP and IFRSs on materiality, an entity would not need to disclose information that is immaterial. For the purposes of applying the disclosure requirements, the Boards noted that an entity should consider materiality in determining how much information to provide.

Disaggregation of revenue (paragraphs 114–116)

BC249. Revenue recognized in the statement of comprehensive income is a composite amount arising from many contracts with customers. The revenue could arise from the transfer of different goods or services or from contracts involving different types of customers or markets. The disclosure of disaggregated revenue information helps users to understand the composition of the revenue that has been recognized in a reporting period. The level of disaggregation is important because information is obscured if the disclosure of that information is either too aggregated or too granular.

BC250. In developing the 2010 proposed Update, the Boards observed that existing standards require revenue to be disaggregated and that those standards specify the basis for the disaggregation. For example:

- (a) IAS 18 requires disclosure of the amount of each significant category of revenue recognized during the period, including revenue arising from the sale of goods, the rendering of services, interest, royalties, and dividends.
- (b) Topic 280 on segment reporting and IFRS 8, *Operating Segments*, require an entity to disclose revenue for each operating segment (reconciled to total revenue) and to

disaggregate its total revenue by products or services (or by groups of similar products or services) and by geographical areas to the extent that the entity's operating segments are not based on different products or services or different geographical areas. Related disclosure is required on the entity's types of products and services and its major customers. However, the amounts disclosed can be measured on a basis that is used internally and might not agree with the measurements used in U.S. GAAP or IFRSs.

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

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

Reconciliation of contract balances (paragraph 117)

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

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

- (a) The cost of preparing and auditing the reconciliation would be high because an entity would be required to measure all unperformed contracts, including executory contracts.
- (b) There is a high level of judgment inherent in executory contracts, including determining when a contract comes into existence.
- (c) The information provided may not be useful for many types of contracts, such as those with a short duration.

Hence, the Boards decided to propose in the 2010 proposed Update that an entity should disclose a reconciliation from the opening to the closing balance of the contract assets and contract liabilities recognized in the statement of financial position.

BC256. Preparers and users expressed differing views on the proposal to disclose a reconciliation of contract balances. Most preparers commented that it would be costly to compile and present the information required by the reconciliation of contract assets and contract liabilities. Furthermore, some preparers doubted whether, given the preparation costs, the disclosure would be cost-beneficial. In contrast, users stated that the information that would be provided by the reconciliation is not available from other qualitative or quantitative disclosure requirements. And, although the reconciliation would impose costs on preparers, those users commented that the disclosure was important because it would help them to understand the interaction between revenue that has been recognized and the movements in cash and receivables, as well as to understand contract assets and contract liabilities.

BC257. In light of the feedback received from some preparers, the Boards considered whether to require an entity to disclose the reconciliation only if specified criteria are met. For instance, those criteria might include the following:

- (a) The contract meets specified attributes (for example, it is a long-term contract or the entity operates in a particular industry).
- (b) The contract assets or contract liabilities are classified as noncurrent assets or liabilities in the statement of financial position.

BC258. The Boards decided that this would not be a viable approach because of the difficulty in clearly identifying those types of contracts or industries for which a reconciliation would provide (or would not provide) useful information. Even though users suggested that the reconciliation would be especially useful for industries or entities with long-term contracts, such as construction contracts and outsourcing contracts, they also indicated that there would be other circumstances in which a reconciliation of contract balances would be useful. Furthermore, the criteria in paragraph BC257 could result in excluding some of an entity's contract assets and contract liabilities from the reconciliation. If that were to happen, the disclosure would not represent a reconciliation of the items in the financial statements.

BC259. Therefore, the Boards affirmed the proposal to require the reconciliation of contract balances because of the importance of that information to users of financial statements. The Boards also decided that the reconciliation should be presented in a tabular format because users

commented that this would make the reconciliation easier to understand and would facilitate comparisons between entities.

BC260. The Boards observed that an entity should consider whether the information to be disclosed in the reconciliation would be material. As explained in paragraph BC248, the Boards think that the guidance in existing U.S. GAAP and IFRSs not to disclose immaterial information would apply in determining:

- (a) When the reconciliation is provided (for example, the reconciliation could be immaterial for entities that operate cash sales businesses)
- (b) How much detail is provided in that reconciliation (that is, how many reconciling items are presented).

Disclosure of remaining performance obligations (paragraphs 119–121)

BC261. In the 2010 proposed Update, the Boards proposed that an entity should disclose the amount of its remaining performance obligations and the expected timing of the satisfaction of those performance obligations (in one-year time bands for each of the subsequent three years and a fourth time band for all performance obligations remaining after three years). That was because the reconciliation of contract balances would not result in the disclosure of information about an entity's performance obligations on a gross basis. The Boards determined that separately disclosing the remaining performance obligations would enable users to:

- (a) Assess the risks associated with future revenues. In general, users see the outcome as more uncertain if satisfaction of the performance obligation occurs at a much later date because it will be subject to a greater number of factors and uncertainties than will a more immediately satisfied performance obligation.
- (b) Understand the timing and amount of revenue to be recognized from existing contracts.
- (c) Analyze trends in the amount and timing of revenue.
- (d) Obtain consistency in the reporting of "backlog," which often is disclosed by entities in management commentary but calculated on a variety of bases.
- (e) Understand how changes in judgments or circumstances might affect the pattern of revenue recognition.

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

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

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

BC263. In redeliberating the proposed disclosure of remaining performance obligations, the Boards observed that the circumstances that led them to propose the disclosure remained unchanged because they had affirmed their proposal to require a reconciliation of contract balances to be provided on a net basis rather than on a gross basis. The Boards also observed that in some industries in which long-term contracts are essential to the business model, disclosure of a similar (but non-GAAP) nature is demanded by analysts as a critical input to the evaluation of revenue and revenue growth. However, because of the concerns raised by users and preparers about the proposed disclosure, the Boards considered the disclosure of different amounts of future revenues from contracts with customers and whether those amounts provide users of financial statements with useful information.

BC264. The Boards decided to retain the proposal in the 2010 proposed Update (that is, the disclosure of future revenue from contracts with customers

should be the gross amount of performance obligations remaining from contracts with an original expected duration of more than one year). The Boards decided against requiring the disclosure of future revenue from contracts with customers based on the other amounts for the following reasons:

| Measure | Reason for Rejection |
|--|--|
| <p>Disclosure of the carrying amount of contract liabilities (that is, scheduling when advance payments received from customers will be recognized as revenue)</p> | <p>The Boards decided that the proposal in the 2010 proposed Update would provide users with more relevant information (for example, for the purposes outlined in paragraph BC261).</p> <p>The Boards noted that some entities currently disclose a maturity analysis of their contract liabilities that will be recognized as revenue in future reporting periods (particularly entities that provide subscription or information technology support services over time, for which customers typically pay in advance). The Boards think that those entities would continue to provide that information if users demand it.</p> |
| <p>Disclosure of the gross amount of performance obligations remaining from all contracts with customers (that is, including those contracts with an original expected duration of one year or less)</p> | <p>The Boards rejected this alternative on a cost-benefit basis. They think that the cost of preparing the disclosure for short-term contracts would not be offset by the benefits provided by that disclosure.</p> |
| <p>Disclosure of order book/backlog, including cancellable contracts or the disclosure of estimated future revenue of the entity including anticipated contracts</p> | <p>Although the disclosure of this information was supported by users, the Boards rejected this disclosure because it would have included revenue that is outside the scope of the proposed guidance (that is, the disclosure would include future contracts and</p> |

| Measure | Reason for Rejection |
|---------|--|
| | contracts that are wholly unperformed and that can be terminated without penalty). |

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

- (a) Affirm the proposal in the 2010 proposed Update to exclude from the disclosure those contracts that have an original expected duration of one year or less.
- (b) Propose that, as a practical expedient, an entity need not disclose the amount of remaining performance obligations if the nature of the contract is such that the entity recognizes revenue as invoiced. The Boards proposed this practical expedient after observing that, in some cases, an entity would not need to strictly apply each step of the model to be able to recognize revenue. This would be the case for some “cost plus” or “time and materials” contracts in which the contract price is based on a rate per unit of input (for example, hours worked and materials consumed). With those contracts, an entity would be able to recognize revenue as it performs the work and consumes the materials in the amount specified in the contract without needing to apply each step of the revenue model. By permitting those contracts to be excluded from the scope of the proposed disclosure, the Boards are ensuring that an entity would not be required to determine the transaction price and allocate that amount to the performance obligations in the contract for the purposes of preparing the disclosure.

BC266. Many respondents also disagreed with the proposal in the 2010 proposed Update that prescribed the basis for presenting the maturity analysis (that is, by requiring the remaining performance obligations to be scheduled into one-year time bands). Respondents disagreed with the rigidity of those time bands and some also expressed a concern that the scheduling could imply a false degree of precision in the expectation of when a performance obligation will be satisfied. Hence, the Boards

decided to permit an entity to choose whether to provide that explanation:

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

Performance obligations (paragraph 118)

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

Onerous performance obligations (paragraphs 122 and 123)

BC268. The Boards decided that the disclosures relating to onerous performance obligations recognized in accordance with the proposed guidance should be consistent with the existing onerous contract disclosures in IAS 37.

Assumptions and uncertainties (paragraphs 124–127)

BC269. U.S. GAAP and IFRSs have general requirements for the disclosure of significant accounting estimates and judgments made by an entity. Because of the importance placed on revenue by users of financial statements, the Boards decided to propose specific disclosure requirements on the estimates used and judgments made in determining the amount and timing of revenue recognition.

BC270. The FASB’s Emerging Issues Task Force (EITF) reached a similar conclusion when developing the guidance in Section 605-25-50 for the disclosure of multiple-element arrangements. The EITF consulted extensively to develop disclosures to communicate the judgments used and their effect on the recognition of revenue from multiple-element arrangements. After considering whether those disclosures could apply appropriately to all contracts with customers, the Boards decided that

the proposed guidance should include disclosures on significant judgments that are similar to those required by Section 605-25-50.

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

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

Disclosures required for interim financial statements

BC272. Absent specific disclosure requirements for interim financial statements, an entity would apply Topic 270 on interim reporting or IAS 34, *Interim Financial Reporting*, to determine the information about revenue from contracts with customers that the entity should disclose in its interim financial statements. Those standards require, as a general principle, that an entity disclose information about significant changes in financial position and performance of the entity since the end of the last annual reporting period. However, because information about revenue is crucial for users of financial statements to make informed assessments about an entity's financial performance and prospects, the Boards decided to specify the disclosures about revenue and contracts with customers that an entity should provide in interim financial statements. Hence, users would be provided with consistent and comparable disclosures in interim periods because specifying the required disclosures would limit the risk that entities could reach different conclusions on what represents a significant change and how information about that significant change should be presented in the interim financial statements.

BC273. The disclosures specified by the Boards relate to information that would be expected to change significantly from period to period; therefore, disclosure of that information would be consistent with the general disclosure principles in Topic 270 and IAS 34. The Boards considered, but ultimately rejected, an alternative approach of specifying that an entity should disclose a disaggregation of revenue in interim financial statements and to specify other disclosures that an entity might need to

disclose only if that information significantly changes from period to period. Although, in some cases, that alternative approach could limit the volume of information that would be required to be disclosed in interim financial statements, the Boards decided that the alternative might result in diversity in the amount of information that some entities disclose in interim financial periods given the judgement associated with identifying what represents a significant change to the recognition of revenue.

Implementation guidance (paragraphs IG1–IG58)

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

Sale of a product with a right of return (paragraphs IG2–IG9)

BC275. In some contracts, an entity transfers a good to a customer and also grants the customer the right to return the good to the entity. The Boards decided that, conceptually, a contract with a right of return includes at least two performance obligations—a performance obligation to provide the good to the customer and a performance obligation for the return right service, which is a standready obligation to accept the goods returned by the customer during the return period.

BC276. In relation to performance obligations to provide goods to customers, the Boards decided that in effect an entity has made an uncertain number of sales. That is because it is only after the return right expires that the entity will know with certainty how many sales it has made (that is, how many sales did not fail). Therefore, the Boards decided that an entity should not recognize revenue for the sales that are expected to fail as a result of customers exercising their return rights. Instead, for those sales, the entity should recognize a liability for its obligation to refund amounts to customers.

BC277. The Boards decided that in determining the amount of revenue to recognize (and hence the amount of the refund obligation), an entity should use the principles for recognizing and measuring variable consideration. Consistent with those principles, if an entity is not reasonably assured of the amount of consideration to which it will be entitled (considering the quantity of goods to be returned), the entity would recognize any consideration received as a refund liability.

- BC278. The Boards considered whether to account for the return right service as a performance obligation separate from the refund liability. If an entity does not recognize a performance obligation for the return right service, it would have recognized all of the revenue and margin in the contract once the customer obtains control of the good. Such an outcome might not faithfully depict the entity's performance under the contract. However, the Boards noted that accounting for the return right service as a performance obligation that is separate from the refund liability would typically require the entity to estimate the standalone selling price of that service. Given that in many cases, the number of returns is expected to be a small percentage of the total sales and the return period is often short (such as 30 days), the Boards decided that the incremental information provided to users by accounting for the return right service as a separate performance obligation would not justify the complexities and costs of doing so. Therefore, the Boards decided that the return right service should not be accounted for as a separate performance obligation.
- BC279. A right of return gives the entity a contractual right to recover the good from the customer if the customer exercises its option to return the good and obtain a refund. The Boards decided that the right to recover the good should be recognized as an asset rather than offset against the refund liability. The Boards observed that recognizing the asset separately from the refund liability provides greater transparency and ensures that the asset is considered for impairment testing.

Product warranties and product liabilities (paragraphs IG10–IG15)

- BC280. When an entity sells a product (whether that product is a good or service) to a customer, the entity may also provide the customer with a warranty on that product. The warranty might be described as, for example, a manufacturer's warranty, a standard warranty, or an extended warranty. The Boards decided to provide specific guidance on applying the revenue model to warranties because many contracts with customers for the sale of products include a warranty and the nature of that warranty may vary across products, entities, and jurisdictions.
- BC281. In the Discussion Paper, the Boards proposed accounting for all warranties consistently because a unifying feature of all warranties is that an entity promises to stand ready to replace or repair the product in accordance with the terms and conditions of the warranty. The Discussion Paper proposed that a promise to stand ready provides the customer with a service of warranty coverage, which would be a separate performance obligation to which revenue would be attributed. However, most respondents to the Discussion Paper stated that the accounting for warranties should reflect the fact that some product

warranties are different from others. Some warranties protect the customer from defects that exist when the product is transferred to the customer, and other warranties protect the customer from faults that arise after the product has been transferred to the customer. Those respondents commented that the customer is not receiving a separate service if the warranty only protects the customer from the product being defective at the time of sale. Consequently, any subsequent repairs or replacements are additional costs of providing the product and, therefore, relate to an entity's past performance.

BC282. The 2010 proposed Update proposed that an entity should distinguish between warranties on the basis of the objective of the warranty (that is, the nature of the protection promised to the customer). The 2010 proposed Update identified the following types of warranties:

- (a) A "quality assurance warranty"—a promise that the product is free from defects at the time of sale
- (b) An "insurance warranty"—a promise to repair or replace the product if a fault arises within a specified period (normally subject to some conditions).

BC283. The 2010 proposed Update would have required an entity to account for some warranties differently than other warranties. However, in this proposed Update, the Boards decided not to distinguish between warranties only on the basis of the nature of the protection promised to the customer. They made this decision because almost all respondents to the 2010 proposed Update commented that it could be difficult to determine *when* a fault has arisen in a product. For example:

- (a) In the manufacturing industry, products often go through rigorous inspection processes before delivery to the customer, and an entity may not be aware of faults at the time of delivery.
- (b) In the software industry, it is not clear how an entity would determine whether a software bug fix is repairing a latent defect or a defect that occurred after the product was transferred to the customer.

BC284. Instead, paragraphs IG10–IG13 of this proposed Update would require an entity to identify a promised warranty as a separate performance obligation if either of the following criteria is met:

- (a) The customer has the option to purchase the warranty separately from the entity.
- (b) The warranty provides a service to the customer in addition to the assurance that the entity's past performance was as specified in the contract.

BC285. A promised warranty that does not meet the criteria in those paragraphs is not a performance obligation. In effect, those criteria provide a

different basis for distinguishing between an insurance warranty (which is a separate performance obligation and is described in this proposed Update as a “service-type warranty”) and a quality assurance warranty (which is not a performance obligation and is described in this proposed Update as an “assurance-type warranty”).

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

BC286. For some types of warranties, the entity either sells separately or negotiates separately with the customer so that the customer can choose whether to purchase the warranty coverage. That fact provides objective evidence that the promised warranty provides a service to the customer in addition to the promised product. Consequently, the Boards decided that the promised warranty would be a separate performance obligation in accordance with paragraphs 28 and 29.

BC287. For warranties that are not sold separately by the entity or negotiated separately with the customer, the Boards decided that those promised warranties should also be identified as separate performance obligations if the facts and circumstances suggest that the warranty (or a part of the warranty) provides a service to the customer in addition to the assurance that the entity’s past performance was as specified in the contract. The Boards noted that this decision would:

- (a) Provide a clear principle that allows an entity to account for economically similar warranties in a similar manner, regardless of whether the warranties are separately priced or negotiated.
- (b) Be consistent with the general principles for identifying separate performance obligations.
- (c) Remove the bright line in existing U.S. GAAP that distinguishes between different types of warranties based solely on whether the warranty is separately priced.

BC288. A warranty that meets the criteria in paragraphs IG10–IG15 also meets the definition of an insurance contract. However, in their insurance contracts project, the Boards have tentatively decided that warranties issued directly by a manufacturer, dealer, or retailer should be within the scope of the revenue standard. Warranties issued by third parties are within the scope of the insurance contracts project.

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

BC289. The Boards considered whether an assurance-type warranty should be accounted for as either of the following:

- (a) A separate liability to replace or repair a defective product
- (b) An unsatisfied performance obligation because the entity has not provided the customer with a product that is free from defects at the time of sale.

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

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

BC291. Accordingly, the Boards decided that an entity should recognize assurance-type warranties as a separate liability to replace or repair a defective product. This proposed Update would require an entity to recognize a warranty liability and corresponding expense when it transfers the product to the customer, and the liability would be measured in accordance with Topic 450 on contingencies or IAS 37. In contrast to the accounting for service warranties, an entity would not attribute any transaction price (and therefore revenue) to an assurance-type warranty. Some warranties may include both assurance features and service features. If an entity cannot reasonably account for those assurance features of the warranty separately from the service features,

the Boards decided that an entity should be allowed to account for the warranties together as a single performance obligation. That accounting would ensure that the entity does not overstate the recognition of revenue at the time the product transfers to the customer and also relieves the entity from identifying and accounting separately for the two components of the warranty coverage.

Statutory warranties

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

Product liability laws

BC293. The Boards clarified that product liability laws do not give rise to performance obligations. These laws typically require an entity to pay compensation if one of its products causes harm or damage. The Boards noted that an entity should not recognize a performance obligation arising from these laws because the performance obligation in a contract is to transfer the product to the customer. To the extent that the product is defective, the entity would recognize a liability for the expected costs to repair or replace the product (as discussed in paragraph IG15). Any obligation of the entity to pay compensation for the damage or harm that its product causes is separate from the performance obligation. The Boards noted that an entity would account for this obligation separately from the contract with the customer and in accordance with the guidance on loss contingencies in Subtopic 450-20 or IAS 37.

Principal versus agent considerations (paragraphs IG16–IG19)

BC294. Existing standards require an entity to assess whether it is acting as a principal or an agent when goods or services are transferred to end customers. That assessment determines whether an entity recognizes revenue for the gross amount of customer consideration (if the entity is a principal) or for a net amount after the principal is compensated for its goods or services (if the entity is an agent). Under the proposed guidance, principals and agents would have different performance obligations. A principal controls the goods or services before they are transferred to customers. Consequently, the principal's performance obligation would be to transfer those goods or services to the customer. In contrast, an agent does not control the goods or services before they are transferred to customers. The agent facilitates the sale of goods or services between a principal and the customer. Therefore, an agent's performance obligation would be to arrange for another party to provide the goods or services to the customer. The transaction price attributable to an agent's performance obligation would be the fee or commission that the agent receives for providing those services.

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

Customer options for additional goods or services (paragraphs IG20–IG24)

BC296. In some contracts, customers are given an option to purchase additional goods or services. In developing the proposed guidance, the Boards considered when those options should be accounted for as a separate performance obligation. During those discussions, the Boards observed that it can be difficult to distinguish between the following:

- (a) An option that the customer pays for (often implicitly) as part of an existing contract, which would be a performance obligation to which part of the transaction price is allocated
- (b) A marketing or promotional offer that the customer did not pay for and, although made at the time of entering into a contract, is

not part of the contract, and which would not be a performance obligation in that contract.

BC297. Similar difficulties in distinguishing between an option and an offer have arisen in U.S. GAAP for the software industry. In response to those practice issues, Section 985-605-15 on scope and scope exceptions for software indicates that an offer of a discount on future purchases of goods or services would be presumed to be a separate option in the contract if that discount is significant and is incremental both to the range of discounts reflected in the pricing of other elements in that contract and to the range of discounts typically given in comparable transactions. The existing notions of significant and incremental form the basis for the principle of a material right that is used to differentiate between an option and a marketing or promotional offer. However, the Boards observed that even if the offered discount is not incremental to other discounts in the contract, in some cases, it could nonetheless give rise to a material right to the customer. Therefore, the Boards decided not to carry forward that part of the guidance in Section 985-605-15 into the proposed Update.

Allocating the transaction price

BC298. In accordance with the proposed guidance, an entity would be required to determine the standalone selling price of the option so that part of the transaction price is allocated to the performance obligation. In some cases, the standalone selling price of the option may be directly observable, or it may be indirectly observable by, for example, comparing the observable prices for the goods or services with and without the option. In many cases, though, the standalone selling price of the option would need to be estimated.

BC299. Option pricing models can be used to estimate the standalone selling price of an option. The price of an option includes the intrinsic value of the option (that is, the value of the option if it were exercised today) and its time value (that is, the value of the option that depends on the time until the expiration and the volatility of the price of the underlying goods or services). The Boards decided that the benefits to users of allocating some of the transaction price to the price and availability guarantees inherent in the time value component of the option price would not justify the costs and difficulties to do so. However, the Boards decided that an entity should be able to readily obtain the inputs necessary to measure the intrinsic value of the option in accordance with paragraph IG23 and that those calculations should be relatively straightforward and intuitive. This measurement approach is consistent with the measurement application guidance for customer loyalty points in IFRIC 13, *Customer Loyalty Programmes*.

Renewal options

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

the contract because the underlying goods or services may be of a different nature.

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

Customers' unexercised rights (breakage) (paragraphs IG25–IG28)

- BC305. Some respondents to the 2010 proposed Update requested that the Boards provide guidance on how to account for a customer's nonrefundable prepayment for the right to receive goods or services in the future. Common examples include the purchase of gift cards and nonrefundable tickets.
- BC306. The Boards noted that the guidance on the allocation of the transaction price to customer options in the 2010 proposed Update implicitly explained how to account for situations in which the customer does not exercise all of its contractual rights to those goods or services (that is, breakage). However, the 2010 proposed Update did not explain how to account for breakage in situations in which there is only one performance obligation in the contract (that is, there is no allocation and, hence, no need to determine a standalone selling price).
- BC307. Consequently, the Boards included implementation guidance in this proposed Update on the accounting for breakage (paragraphs IG25–IG28). That guidance is consistent with the principles in the proposed guidance for accounting for customer options. Thus, an entity would recognize revenue from breakage as it performs under the contract on the basis of the estimated pattern of customers exercising their rights (that is, a proportional approach). That approach effectively increases the selling price of the individual goods or services transferred to the customer to include the revenue from the entity's estimate of unexercised rights. The Boards decided that this approach represents

the most appropriate pattern of revenue recognition for breakage because if an entity believed that customers would exercise all of their rights (that is, if the entity did not expect any breakage), the entity might increase the price of its goods or services. For example, an airline that sells nonrefundable tickets would presumably charge a higher price per ticket if there was no expectation of breakage.

BC308. The Boards also decided that an entity must be reasonably assured of a breakage amount to recognize revenue. Otherwise, the entity's performance obligation to stand ready to provide future goods or services could be understated.

BC309. The Boards considered, but rejected, the approach that would have required an entity to recognize estimated breakage as revenue immediately on the receipt of prepayment from a customer. The Boards decided that because the entity has not performed under the contract, recognizing revenue would not be a faithful depiction of the entity's performance and also could understate the entity's obligation to stand ready to provide future goods or services.

Licensing and rights to use (paragraphs IG33–IG37)

BC310. When developing implementation guidance on licensing and rights to use for the 2010 proposed Update, the Boards observed that licensing arrangements often have characteristics that are similar to those of a lease. The primary similarity is that in both cases a customer purchases the right to use, but not own, an asset of the entity. Despite those similar characteristics, the current accounting for leases and licensing arrangements often differs. Accounting for a lease in accordance with existing standards often results in a lessor recognizing income over time as the lessee receives the benefit of the use of the leased asset. In contrast, accounting for a licensing arrangement in accordance with existing standards often results in an entity recognizing revenue at a point in time (typically upon commencement of the license period).

BC311. Consequently, the Boards considered the differences between the nature of the promised asset in a licensing arrangement and the nature of the promised asset in a lease to determine whether those differences justify a different pattern of revenue or income recognition. The Boards considered differences relating to the following:

- (a) Tangible versus intangible assets
- (b) Exclusive versus nonexclusive rights.

BC312. The Boards decided that it would be difficult to justify why the accounting for a promised asset should differ depending on whether the asset is tangible or intangible. Moreover, in the Boards' conceptual

frameworks, the discussion on the nature of assets deemphasizes the physical nature of assets. Hence, the Boards considered the exclusive versus the nonexclusive nature of rights.

- BC313. Leases, by nature, grant a lessee exclusive rights because the lessor cannot grant the right to use a leased asset to more than one lessee at the same time. In contrast, for intellectual property, an entity can grant similar rights to more than one customer at the same time under substantially similar terms. Hence, the 2010 proposed Update proposed that an entity's performance obligation to grant exclusive rights would be satisfied over time. In contrast, an entity would satisfy a performance obligation to grant nonexclusive rights at a point in time. The 2010 proposed Update highlighted the fact that rights may be exclusive on the basis of many factors, such as time, geographical region, medium, or distribution channel.
- BC314. Most respondents to the 2010 proposed Update disagreed with the proposal that an entity should distinguish between an exclusive license and a nonexclusive license. Those respondents suggested that exclusivity does not affect the nature of an entity's performance obligation. Therefore, they believe that it is counterintuitive to have different patterns of revenue recognition depending on whether a license is exclusive. Respondents suggested that regardless of whether rights are exclusive, a customer obtains control of a promised asset at inception of a license period when the customer is able to use and benefit from the license. In addition, those respondents expressed concerns about the operability of the proposal and highlighted that any right to use is arguably exclusive.
- BC315. The Boards agreed with those respondents who expressed concerns about the proposed distinction between exclusive rights and nonexclusive rights. The Boards considered whether another distinction would be appropriate and operable but decided that any distinction would be arbitrary and difficult to apply in practice because of the many ways in which an entity can grant rights to use intellectual property. Having decided against distinguishing between types of licenses and rights to use intellectual property, the Boards considered two alternative views of the nature of an entity's performance obligation to grant to a customer a license or right to use intellectual property:
- (a) A license represents a performance obligation that the entity satisfies at the point in time when the customer obtains control of the license (that is, the use and benefit of the license).
 - (b) A license represents access to the entity's intellectual property that the entity satisfies continuously over the pattern of use of the underlying rights to use the entity's intellectual property by the customer.

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

Repurchase agreements (paragraphs IG38–IG48)

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

A forward or a call option (paragraphs IG40–IG42)

BC318. If the entity has an unconditional obligation or right to repurchase an asset (that is, a forward or call option), the Boards decided that the customer does not obtain control of the asset and, therefore, no revenue would be recognized. That is because the customer is constrained in its ability to direct the use of and obtain substantially all the remaining benefits from the asset. Because the customer is obliged to return, or to stand ready to return, the asset to the entity, the customer cannot use up or consume the entire asset. Moreover, the customer cannot sell the asset to another party (unless that sale is subject to a repurchase agreement, in which case the customer's benefit from the sale is constrained).

BC319. In theory, the customer is not constrained in its ability to direct the use of and obtain substantially all the benefits from the asset if the entity agrees to repurchase, at the prevailing market price, an asset from the customer that is substantially the same and is readily available in the marketplace. However, the Boards noted that an entity would be unlikely to enter into such a transaction.

BC320. In contrast, if the entity has a conditional right to repurchase an asset, the customer would obtain control of the asset and, therefore, revenue would be recognized subject to any sales return liability. Those agreements are common in the sale of perishable products and in the pharmaceutical industry to ensure that the customer (that is, dealer or retailer) does not sell products to consumers beyond the expiration date and to protect the entity's reputation in the marketplace. In those circumstances, the Boards decided that the substance of the repurchase agreement is the sale of a product with a put option and that revenue should be recognized accordingly.

A put option (paragraphs IG43–IG48)

BC321. In the 2010 proposed Update, the Boards decided that if the sale and repurchase agreement resulted in the entity's unconditional obligation to repurchase the asset at the customer's request (that is, a put option), the customer would obtain control of the asset. That is because the customer is neither obliged to return the asset nor obliged to stand ready to do so. Therefore, the customer has the ability to direct the use of and obtain substantially all the remaining benefits from the asset (that is, the customer can sell, use up, or consume the entire asset and choose not to exercise the put option). The Boards decided that the entity should account for its obligation to stand ready to repurchase the asset consistently with the accounting for the sale of a product with a right of return (see paragraphs BC275–BC279). That results in the entity recognizing the following:

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

BC322. Some respondents questioned whether that accounting would be appropriate in all cases in which a customer has a put option. For instance, some noted that, in some such cases, the contract appears economically to be similar to a lease (with a purchase option) rather

than a right of return. That might be the case if the entity is required to repurchase the asset at a price that is lower than the original sales price and the surrounding facts and circumstances indicate that the customer will exercise its put option. In those cases, the difference between the original sales price and the repurchase price can be viewed as the amount the customer pays for a right to use the asset, compensating the entity for the decline in the value of the asset. Some respondents noted that, in other cases, the contract is in effect a financing arrangement.

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

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

- BC324. If an entity enters into a contract with a repurchase agreement and the customer does not obtain control of the asset, the Boards decided that:
- (a) The contract should be accounted for as a lease in accordance with Topic 840 or IAS 17, *Leases*, if the effect is that the customer is paying for a right to use the asset.
 - (b) The contract is a financing arrangement if the effect is that the entity is paying interest.
- BC325. To ensure consistent accounting in U.S. GAAP and IFRSs for a financing arrangement that arises from a contract with a customer, the Boards decided to provide guidance consistent with Subtopic 470-40 on product financing arrangements. Consequently, the FASB decided to replace Subtopic 470-40. It noted that the remaining guidance in Subtopic 470-40 addresses situations in which an entity arranges for another party to purchase products on its behalf and agrees to purchase

those products from the other party. In those cases, the entity is required to recognize the products as an asset and to recognize a related liability when the other party purchases the product. The FASB noted that the proposed model would result in similar accounting when the other party acts as an agent of the entity (that is, the other party does not obtain control of the products).

Transition, effective date, and early adoption (paragraphs 131–134)

Transition (paragraphs 132–134)

- BC326. The Boards affirmed their proposal in the 2010 proposed Update that an entity should apply the proposed guidance retrospectively in accordance with the guidance on accounting changes and error corrections in Topic 250 or IAS 8. Retrospective application would ensure that all contracts with customers are recognized and measured consistently both in the current period and in the comparative periods presented regardless of whether those contracts were entered into before or after the requirements became effective. Consequently, revenue recognized in the current period would be understandable and comparable because an entity would account for all of its contracts with customers on the same basis. Furthermore, retrospective application would provide users of financial statements with useful trend information across the current period and comparative periods. Feedback received from users confirmed that retrospective application is particularly important for them to be able to understand trends in revenue, which are significant to the financial statements.
- BC327. Other transition approaches considered by the Boards were for an entity to apply the proposed guidance on a prospective basis, either for all new contracts entered into after the effective date or for all contracts (new and existing) from that date. The Boards rejected those alternatives because revenue recognized after the effective date would not be comparable with revenue recognized before that date, thereby impairing comparability and the usefulness of trend information. Moreover, if the proposals were applied prospectively only for new contracts, the recognition and measurement of revenue would not be comparable in the current period or in any subsequent periods in which revenue is recognized from contracts that were entered into before and after the effective date.
- BC328. Many respondents to the 2010 proposed Update commented that applying the proposed guidance retrospectively would be burdensome, especially for those entities with long-term contracts or with large and

complex multiple-element arrangements. The main concerns raised by those respondents were:

- (a) Historical information may be inaccessible because it is retained in a wide range of systems and manual records that change over time.
- (b) Contracts may have started before the issuance of the standard, and information to apply the requirements retrospectively may not have been collected or retained.
- (c) The information needed to estimate standalone selling prices of goods or services in a contract with many performance obligations may not exist, especially when that good or service was not sold separately.
- (d) Entities make assumptions and estimates throughout a contract's life, and it may not be possible to re-create the circumstances that apply historically without the use of hindsight.

BC329. The Boards decided that although retrospective application would generally impose increased preparation costs, those would be outweighed by the increased benefits to users of financial statements. Consequently, the Boards considered how the burden of retrospective application could be eased while, at the same time, retaining the benefits of comparability and consistency that retrospective application would provide. The Boards noted that some of those concerns would be addressed by:

- (a) The existing guidance in Topic 250 and IAS 8, which limit the retrospective application of an accounting policy if it is impracticable
- (b) Changes made to the proposed guidance during the redeliberations on the 2010 proposed Update, which have brought some of the guidance closer to existing practices (see Appendix B)
- (c) Specifying a long lead time between issuing the standard on revenue from contracts with customers and its effective date, which would reduce both the historical information that needs to be collected and the extent that hindsight is needed to apply that standard.

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

| Relief | Rationale |
|---|------------------|
| <i>Relief that reduces the number of contracts that require restatement</i> | |

| Relief | Rationale |
|--|---|
| <p>For contracts completed before the date of initial application, an entity need not restate contracts that begin and end within the same annual reporting period.</p> | <p>In considering whether an entity should be required to review and restate all contracts completed before the date of initial application, the Boards decided that trend information should be preserved for those completed contracts that span annual reporting periods. Therefore, the Boards decided to limit the relief to only those contracts that begin and end within the same annual reporting period because the amount and timing of revenue recognition relating to those contracts would not change between annual reporting periods. The Boards noted that this proposed relief would significantly reduce the transition burden on those entities that have a large number of short-term contracts.</p> <p>A consequence of this relief is that revenue reported in <i>interim</i> periods before and after the effective date would not necessarily be accounted for on a comparable basis. The Boards expect that an entity would not use this relief if it operates in an industry in which comparability across interim reporting is particularly important to users of financial statements.</p> |
| <p><i>Relief that simplifies how an entity restates contracts with customers</i></p> | |
| <p>For contracts completed before the date of initial application and that have variable consideration, an entity is permitted to use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods.</p> | <p>Full retrospective application of the standard in accordance with Topic 250 or IAS 8 would require an entity to determine the estimates it would have made at each of the reporting dates in the comparative periods. The Boards considered that making those estimates in the comparative years would increase the complexity and</p> |

| Relief | Rationale |
|--|--|
| | <p>costs of retrospective application.</p> <p>By allowing an entity to use hindsight in estimating variable consideration, the Boards decided that transition would be simplified for the following reasons:</p> <ul style="list-style-type: none"> • The amount of information an entity would need to collect contemporaneously through the transition period would be reduced. • The entity would not need to determine the transaction price at each period end. |
| <p><i>Reliefs that simplify retrospective application of other aspects of the proposed guidance</i></p> | |
| <p>An entity need not evaluate whether a performance obligation is onerous before the date of initial application unless an onerous contract liability was recognized previously for that contract in accordance with the requirements that were effective in those comparative periods.</p> | <p>The Boards propose this relief from retrospective application for the following reasons:</p> <ul style="list-style-type: none"> • Revenue would not be restated and, therefore, the trend information for revenue would be unaffected. • Under existing guidance, an entity may not have recognized a liability for a performance obligation that would be onerous under the new standard. Consequently, it may be unduly costly and burdensome for an entity to evaluate whether a contract would have been onerous at each reporting date in the comparative periods. |

| Relief | Rationale |
|--|--|
| <p>For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognize that amount as revenue (as specified in paragraph 119).</p> | <p>The Boards decided that the disclosure of the remaining performance obligations (as would be required by paragraph 119) should not be required for periods presented before the date of initial application of the revenue standard for the following reasons:</p> <ul style="list-style-type: none"> • The disclosure would be most useful for the current period. • The disclosure could be burdensome to prepare for comparative years, especially when trying to avoid the use of hindsight to estimate the transaction price and the expected timing of satisfaction of those performance obligations. |

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

Effective date and early adoption (paragraph 131)

BC332. The 2010 proposed Update did not specify a possible effective date or whether the proposed guidance could be adopted early. At that time, the Boards decided that they would collectively consider the effective dates and early adoption of all of the standards they had targeted to issue in 2011, including revenue recognition. Subsequently, the Boards sought feedback from interested parties through a number of activities, including the following:

- (a) The IASB's *Request for Views on Effective Dates and Transition Methods* and the FASB's Discussion Paper, *Effective Dates and Transition Methods* (October 2010)
- (b) The Boards' joint investor outreach questionnaire (April 2011)
- (c) Consultation with systems providers and preparers.

- BC333. The feedback indicated that stakeholders will require some time to evaluate and plan their individual implementation and transition processes. For this reason, and the fact that the final standard would require retrospective application, the Boards decided that they should allow a long lead time between issuing the final standard and the effective date.
- BC334. The Boards decided that the effective date of the revenue standard should be set to ensure that the start of the earliest comparative period for an entity required to present two comparative annual periods (in addition to the current annual period) would be a few months after the standard is issued. Consequently, the Boards noted that based on their current timetable for the project, the effective date of the revenue standard would be no earlier than annual periods beginning on or after January 1, 2015.
- BC335. The FASB decided not to allow entities to adopt the guidance early because doing so would reduce the comparability of financial reporting in the period up to the effective date of the standard. However, the IASB decided that it would permit early adoption of the standard. The IASB noted that the standard would improve accounting for revenue and, thus, entities should not be precluded from adopting the standard before its effective date. Furthermore, the IASB noted that the standard should resolve some pressing issues in practice arising from existing guidance. The Boards observed that the IASB-only decision to permit early adoption should not result in differences after the effective date in the accounting of revenue between entities applying U.S. GAAP and those entities applying IFRSs that adopt the standard early, even for contracts that straddle the effective date.

Benefits and costs

- BC336. The objective of financial statements is to provide information about an entity's financial position, financial performance, and cash flows that is useful to a wide range of users in making economic decisions. To attain that objective, the Boards try to ensure that the proposed guidance will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. The costs of implementing a new standard might not be borne evenly; however, both the users of financial statements and entities benefit from improvements in financial reporting that facilitate the functioning of markets for capital, including credit, and the efficient allocation of resources in the economy.
- BC337. The evaluation of costs and benefits is necessarily subjective. In making their judgment, the Boards considered the following:
- (a) The costs incurred by preparers of financial statements

- (b) The costs incurred by users of financial statements when information is not available
- (c) The comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information
- (d) The benefit of better economic decision making as a result of improved financial reporting.

BC338. The Boards developed guidance that would result in entities recognizing revenue on a consistent and comparable basis for a wide range of contracts with customers. By accounting for those contracts consistently, the proposed guidance would address many of the weaknesses and inconsistencies inherent in existing revenue guidance, which have contributed to the existence of diverse practices in the recognition of revenue and, as a result, in frequent requests for authoritative guidance on applying existing guidance to specific transactions or other emerging issues. Furthermore, the proposed guidance provides a stable and durable framework that should address revenue recognition issues associated with new types of transactions and industries that emerge in the future.

BC339. The proposed guidance also would improve comparability in the recognition, measurement, and disclosure of revenue across transactions and across entities operating in various industries. Users have indicated that comparable revenue information is useful when assessing the financial performance of an entity and assessing financial performance across a number of entities. Moreover, a common revenue standard would make the financial reporting of revenue comparable between entities that prepare financial statements in accordance with U.S. GAAP or IFRSs.

BC340. In responding to the proposals in the 2010 proposed Update, many preparers and some users did not perceive significant weaknesses in some existing revenue guidance or in the financial information resulting from applying that guidance to some industries. Therefore, those preparers and users questioned whether the benefits from applying a new standard in some industries would be justified by the costs involved in implementing that new standard. However, the Boards decided that the overall benefits of financial reporting that would result from a comprehensive revenue standard being applied consistently across different industries, jurisdictions, and capital markets outweigh the concerns about cost-benefit assessments in particular industries. In addition, the Boards noted that the amount of change for some entities should not be significant. That is because some of the proposed guidance is broadly consistent with existing revenue recognition guidance or generally accepted practices.

- BC341. Nevertheless, the proposed guidance would change some existing revenue recognition practices and, consequently, some entities would need to make systems and operational changes to comply with that guidance. For example, some preparers have indicated that systems and operational changes would be necessary to estimate variable consideration and to account for the effects of the time value of money and contract options. The Boards clarified that many entities would not need to develop systems to account for each contract individually, especially for entities that have a large volume of similar contracts with similar classes of customers. In those cases, the Boards noted that entities should be able to apply the proposed guidance to a portfolio of similar contracts. In addition, some practical expedients have been added to the proposed guidance to simplify compliance with that guidance in circumstances in which the Boards determined that the expedient would have a limited effect on the amount or timing of revenue recognition. As a result of those changes and clarifications, the Boards expect that the costs of the systems and operational changes would be incurred primarily during the transition from existing standards to the new revenue standard, whereas the benefits resulting from increased consistency and comparability in the recognition of revenue would be ongoing. To ease those preparation costs and complexities associated with the transition to the new standard, the Boards proposed a series of reliefs that the entity can choose to use when applying the proposed guidance retrospectively.
- BC342. The proposed disclosures are more robust than disclosure requirements in existing standards. Therefore, the proposed disclosures should result in an entity disclosing additional information to users that explains more clearly the relationship between an entity's contracts with customers and the revenue recognized by the entity in a reporting period. Many users commented that the proposed disclosures would address deficiencies that currently exist in revenue disclosures. In contrast, many preparers expressed concerns about the volume and specificity of the proposed disclosures. The Boards noted that each of the proposed disclosures would provide useful information to users of financial statements if that information disclosed is material to understanding the entity's financial position, performance, and cash flows. Consequently, the Boards clarified that, in accordance with existing guidance on materiality, an entity would not be required to disclose information that is not material.
- BC343. Respondents to the 2010 proposed Update also indicated that although they did not disagree with some of the proposals, they perceived that, in some cases, the costs of implementing them would outweigh the benefits that would be received. As a result of these comments, members and staff of the Boards have consulted extensively across a wide range of industries and jurisdictions (see paragraphs BC7–BC9) to

better understand some of the operational issues arising from those proposals. The Boards considered that feedback in their redeliberations and, as a result, decided to modify or clarify many aspects of the proposed revenue recognition model to reduce the burden of implementing and applying the proposed guidance. Discussion of these considerations and the resulting changes in different aspects of the model is included throughout the basis for conclusions. (For example, paragraphs BC131–BC138 include discussion of the feedback received and changes made to the principles for measuring the transaction price when it includes variable consideration.) The Boards will continue to consult with representatives from various industries and jurisdictions following publication of the proposed guidance.

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

Consequential amendments

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

- BC345. Subtopic 360-20 on real estate sales provides guidance for recognizing profit on all real estate sales, regardless of whether real estate is an output of an entity's ordinary activities.
- BC346. A contract for the sale of real estate that is an output of an entity's ordinary activities meets the definition of a contract with a customer and, therefore, would be within the scope of the proposed guidance. Consequently, the FASB considered the implications of retaining the guidance in Subtopic 360-20 for other contracts. The FASB noted that retaining the existing requirements could result in an entity recognizing the profit or loss on a real estate sale differently depending on whether the transaction is a contract with a customer. However, economically there is little difference between the sale of real estate that is an output of the entity's ordinary activities and the sale of real estate that is not. Hence, the difference in accounting should relate only to the presentation of the profit or loss in the statement of comprehensive income—revenue and expense or gain or loss.
- BC347. Therefore, the FASB decided to amend Subtopic 360-20 to require an entity to apply the recognition and measurement principles of the proposed guidance to contracts for the sale of real estate that is not the output of the entity's ordinary activities. However, the entity would not

recognize revenue but instead would recognize a gain or a loss. The gain or loss would be recognized when the entity transfers control of the promised asset to the purchaser. The amount of gain or loss would be determined using the proposals for determining the transaction price (including the constraint to amounts to which the entity is reasonably assured to be entitled).

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

[Note: Paragraphs BC350 and BC351 in the basis for conclusions on the IASB's Exposure Draft are not used in the basis for conclusions in the FASB's Exposure Draft. Those paragraphs discuss the transition for first-time IFRS adopters.]

BC350. Paragraph not used.

BC351. Paragraph not used.

Application to nonpublic entities

BC352. This section summarizes the FASB's considerations in modifying the application of the proposed guidance for revenue from contracts with customers for nonpublic entities. This section considers the FASB's decisions on the following topics:

- (a) Onerous performance obligations (paragraph BC353)
- (b) Disclosure (paragraphs BC354–BC367)
- (c) Transition (paragraph BC369).

Onerous performance obligations and not-for-profit contracts (paragraph 90)

BC353. Not-for-profit entities also enter into contracts with customers; however, those contracts may not always have a profit-making objective because they are intended to provide a social benefit or charitable purpose. Because the latter contracts are usually loss making, applying the onerous test to them would result in recognition of a loss when the contract is entered into, which may be in advance of when the service is provided and the costs incurred. That result would be inconsistent with the objective of financial reporting for not-for-profit entities, particularly in providing information about the relation of services provided to the resources used to provide them (paragraphs 38, 39, 51, and 52 of FASB Concepts Statement No. 4, *Objectives of Financial Reporting by Nonbusiness Organizations*). Thus, the FASB observed that applying the onerous test to those contracts would not provide meaningful information to a not-for-profit entity's donors and other resource providers when the objective is not to achieve a profit on the contract. Therefore, the FASB decided that when a not-for-profit entity enters into a contract with a customer for a social benefit or charitable purpose, those contracts should be exempt from applying the onerous test.

Disclosures (paragraph 130)

BC354. The FASB considered the input received from preparers, auditors, and users of nonpublic entity financial statements and the differential needs of users of nonpublic entity financial statements compared with users of public entity financial statements.

BC355. On the basis of the input received and differential user considerations, including the common types of users of nonpublic entity financial statements and the ability of many of those users to access management and cost-benefit considerations, the FASB decided that some of the disclosure requirements should differ for nonpublic entities and that nonpublic entities should be exempt from some of the disclosure requirements.

BC356. The FASB considered the input received from respondents to the 2010 proposed Update who stated that nonpublic entities should not be required to provide the level of disclosures proposed because some of the proposed disclosures would:

- (a) Provide information that is too detailed for many users of nonpublic entity financial statements and would result in disclosure overload.
- (b) Not provide useful information to users of nonpublic entity financial statements. While respondents stated that some of the proposed disclosures would provide useful information, they noted that many users of nonpublic entity financial statements already receive supplemental revenue information on the basis of their individual needs in addition to what is required by existing guidance. Also, many of these users stated that they have direct access to management; therefore, they often are able to obtain additional information from management if requested.
- (c) Not provide benefits that will outweigh the costs due to the efforts involved to prepare and audit the increased volume of disclosures.

BC357. To address the concerns raised by users, preparers, and auditors of nonpublic entity financial statements, the FASB specifically considered the costs and benefits of the following disclosure requirements:

- (a) Disaggregation of revenue
- (b) Disclosure of asset and liability account reconciliations
- (c) Disclosure of remaining performance obligations
- (d) Disclosure of judgments, assumptions, methods, and inputs.

Disaggregation of revenue

BC358. The FASB considered feedback from preparers and auditors of nonpublic entity financial statements that indicated concerns about disclosing disaggregated revenue information, including the costs to audit this information and the potential competitive disadvantage of disclosing proprietary information.

BC359. Feedback from users of nonpublic entity financial statements indicated that information about disaggregation of revenue could provide useful information depending on what information is conveyed; however, some indicated concerns that the disclosures may not provide useful information in all circumstances on the basis of the flexibility allowed under the proposal. Some users who require disaggregated revenue information indicated that they already receive this type of information directly from management outside of the financial statements.

BC360. After considering the cost and benefit concerns raised by preparers, auditors, and users of nonpublic entity financial statements, the FASB decided that nonpublic entities should be exempt from disclosing the quantitative aspects of disaggregation of revenue except for disclosing the amount of revenue recognized from goods or services transferred at a point in time and goods or services transferred to customers over time. This type of disaggregated information would provide users with information about satisfaction of performance obligations and when control of goods or services is transferred and would help users understand the portion of revenue that is related to the qualitative disclosures around measuring progress. The FASB observed that, in most cases, disclosing quantitative information about goods or services should not result in a significant amount of costs to preparers while providing decision-useful information to users.

Disclosure of asset and liability account reconciliations

BC361. Many users of nonpublic entity financial statements stated that the disclosure of asset and liability account reconciliations is not decision useful and they are concerned about the volume of required disclosures. The majority of preparers and auditors of nonpublic entity financial statements indicated concerns about the level of detail and the costs associated with compiling and auditing roll-forward information. Because most users of nonpublic entity financial statements are able to access management, they typically can request additional information about the changes in a particular account, if necessary.

BC362. An exemption from these proposed disclosure requirements is consistent with the decisions reached by the FASB when deliberating potential account reconciliation disclosures for various other projects. The FASB observed that the benefits of providing roll-forward information to users of nonpublic entity financial statements would not outweigh the costs to preparers; therefore, the FASB decided that nonpublic entities should be exempt from the disclosure of asset and liability account reconciliations.

Disclosure of remaining performance obligations

BC363. Feedback received from many nonpublic entity preparers and auditors indicated concerns that, in many cases, it would be difficult and costly to prepare and audit the disclosure of the transaction price allocated to remaining performance obligations and the expected timing of their satisfaction. Many preparers of nonpublic entity financial statements also indicated concerns about disclosing forward-looking information that may be proprietary. Some users of nonpublic entity financial

statements stated that when it is necessary, they receive similar information directly from management in greater detail than what is required. Therefore, requiring this disclosure for all nonpublic entities could result in redundant information that may not provide additional benefit to some users of nonpublic entity financial statements.

- BC364. The FASB considered the feedback received from nonpublic entity stakeholders and observed that providing information about the amount of the transaction price allocated to an entity's remaining performance obligations could likely increase costs for many nonpublic entities without providing significant benefits to users. Therefore, the FASB decided that nonpublic entities should be exempt from disclosing the amount of the transaction price allocated to remaining performance obligations and the expected timing of their satisfaction.

Disclosure of judgments, assumptions, methods, and inputs

- BC365. The disclosures in paragraphs 124–127 about significant judgments are generally consistent with the guidance in Topic 235 on notes to financial statements and Topic 275 on risks and uncertainties, which most nonpublic entity stakeholders have indicated are beneficial. However, the specific guidance in subparagraph 124(a) and (b) and paragraphs 125 and 127 to disclose the judgments, and changes in judgments, and to disclose information about methods, inputs, and assumptions would require additional detail that some users of nonpublic entity financial statements may not consider relevant to their decision making, and many other users can obtain this information directly from management, if necessary.
- BC366. Many users of nonpublic entity financial statements stated that the current guidance to disclose accounting policy information does not provide them with useful information unless (a) the entity has an option to select among acceptable alternatives, (b) the entity has a significant policy change, or (c) it is the year of initial adoption of a new standard. Some users indicated that this type of information would contribute to the high volume of required disclosures and may not provide useful information. Other users, particularly lenders, stated that they do not require details about the underlying accounting because they rely on management's views and estimates and the auditor's report (if provided) to ensure that the financial statements are not materially misstated and that the financial statements are reported in accordance with U.S. GAAP.
- BC367. Therefore, the FASB decided that nonpublic entities should be exempt from the proposed disclosures required by subparagraph 124(a) and (b) and paragraphs 125 and 127 of the proposed guidance.

Disclosure in the interim financial statements of a nonpublic entity

BC368. The FASB decided not to specify disclosures about revenue and contracts with customers that a nonpublic entity should include in its interim financial statements. The FASB noted that nonpublic entities typically do not prepare interim financial statements and many users of the financial statements of nonpublic entities have direct access to management and can obtain supplemental information about interim period revenues. Furthermore, most of the information that the Boards are proposing that a public entity disclose in its interim financial statements is information that a nonpublic entity does not need to disclose in its annual financial statements.

Transition

BC369. The FASB decided that a nonpublic entity should initially apply the guidance in the proposed Update on revenue recognition on a retrospective basis. The FASB acknowledged that nonpublic entities are not required under U.S. GAAP to include comparable periods in their financial statements. However, the FASB noted that if a nonpublic entity includes comparable periods in its financial statements, then it is important that revenue be recognized consistently for both periods presented. The FASB noted that nonpublic entities would be afforded the specified reliefs noted in paragraph 133 of the proposed guidance.

BC370. The FASB decided that the effective date of the new revenue standard for nonpublic entities should be a minimum of one year after the effective date for public entities. The FASB acknowledged that some preparers and auditors of nonpublic entity financial statements rely on the experience of public entities and their auditors in implementing a new standard. In addition, nonpublic entities generally have fewer resources than public entities and, consequently, would benefit from additional time to evaluate the effects of the new revenue standard.

Alternative View

BC371. Mr. Linsmeier disagrees with the publication of this proposed Update for three primary reasons:

- (a) First, he believes that the proposed model has introduced exceptions that permit revenue to be recognized in a manner that is inconsistent with the core principle on which the entire standard is purportedly based. That core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers. Under this principle,

revenue is recognized if and when a customer receives a good or service promised under the contract. Exceptions to this core principle call into question whether the objectives of the proposed standard are being met, which include the development of a robust and consistent framework that improves the comparability of revenue recognition practices across entities, markets, and jurisdictions.

- (b) Second, Mr. Linsmeier objects to the publication of the proposed guidance because he believes that it results in inconsistent guidance for similar economic circumstances within and across standards. The existence of significant inconsistencies within and across standards makes it difficult to apply the proposed model to specific fact patterns that are not addressed in this proposed Update and increases the likelihood that additional circumstance-specific implementation guidance will be needed. In addition, it suggests that the proposed model again fails to meet the objectives for issuing one standard for recognizing revenue from contracts with customers by failing to provide a consistent recognition framework.
- (c) Third, Mr. Linsmeier objects to the publication of this proposed Update because it fails to provide operable, auditable guidance for determining either the amounts or timing of certain items required to be recognized under the proposed guidance.

BC372. Mr. Linsmeier believes that there are multiple examples in the standard that support each of his concerns. The items discussed below are included only to illustrate the potential nature and extent of these issues.

Exceptions to the core revenue recognition principle

BC373. One of the most substantive revisions made to the model in this proposed Update is the introduction of criteria for determining when performance obligations are satisfied over time. One of these new criteria specifies that a performance obligation should be considered satisfied and revenue should be recognized over time by the selling entity when it has the right to payment for performance completed to date as long as it expects to fulfill the contract as promised and the activity under the contract is not creating an asset with an alternate use to the selling entity (for example, it is not building inventory that the entity could sell to another customer). This criterion permits recognition of revenue over time, even when the selling entity has not transferred to the customer any promised goods or services under the contract. For example, it permits an architectural design firm to recognize revenue before the completion of its design drawings and the delivery of its unique work product to a specific customer as long as the design firm has the right to payments for design activities undertaken to date.

BC374. This outcome is inconsistent with a revenue recognition model based on the transfer of a promised good or service to the customer and calls into question whether there is one core principle underlying the proposed guidance or whether the proposed model has introduced a different principle for recognizing revenue in certain situations that is based only on activities being performed by the selling entity under the contract.

Inconsistencies within the proposed Update and across Topics

BC375. Three illustrative examples of significant inconsistencies in the accounting for similar circumstances both within the proposed Update and across related or proposed guidance in other standards include (a) the accounting for revenue to be recognized under licensing arrangements, sales-based royalty arrangements for use of intellectual property, and leasing arrangements, (b) the accounting for certain put options as leases under the proposed Update regardless as to whether the contract meets the definition of a lease, and (c) the accounting for onerous revenue contracts with customers.

- (a) The economics of licenses, royalty arrangements, and leases are very similar; each of these contracts provides a customer with the right to use an asset for a period of time. Within this proposed Update, the timing and amount of revenue that is recognized differ for licenses and sales-based royalty payments for intellectual property and that guidance differs still from the guidance for recognizing revenue in the leasing standard being developed by the two Boards. The comparability and consistency of accounting for similar economic circumstances are impaired by these differences, reducing the decision usefulness of the information provided to users of financial statements.
- (b) This proposed Update also indicates that a put option that requires the selling entity to repurchase an asset at the customer's request at a price that is lower than the original selling price of an asset should be accounted for as a lease, if at contract inception the customer has a significant economic incentive to exercise its right. The scope of the revenue standard excludes contracts that meet the definition of a lease. This guidance, therefore, effectively overrides the scope requirements in both the proposed revenue standard and the proposed leasing standard by requiring contracts that are in the scope of the proposed revenue standard that do not meet the definition of lease to be accounted for as a lease.
- (c) Mr. Linsmeier also finds it inconsistent that the proposed Update only addresses the accounting for losses on onerous contracts for contracts with revenue being recognized over time and then only for those contracts that at inception are expected to have performance obligations that are satisfied over periods of time

greater than one year. For other contracts in the scope of this proposed Update, the basis for conclusions (paragraph BC210) indicates that contracts with performance obligations satisfied at a point in time typically result in the creation of related assets that would be the subject of impairment testing in other standards. However, existing U.S. GAAP provides inadequate guidance on the impairment of inventory that is promised in a sales contract when an entity does not have such inventory in stock and does not yet have a purchase commitment for the inventory. Hence, Mr. Linsmeier believes that the scope of the onerous test will fail to require the immediate recognition of a loss on some performance obligations that an entity expects to be loss making. In addition, he believes that existing and proposed impairment guidance, in its totality, will result in arbitrary differences in the timing and amount of recognition of impairment losses that could significantly challenge the ability of users seeking to compare and understand the nature of the onerous contract issues for different types of revenue contracts.

Concerns about operability and auditability of the proposed guidance

BC376. Finally, the following three circumstances provide examples of situations in which Mr. Linsmeier believes that additional guidance is needed to make this proposed Update both operable and auditable:

- (a) First, guidance is needed for evaluating whether the appropriate amortization period is being employed for contract costs recognized as assets. The proposed Update fails to provide robust conditions for evaluating when the amortization period is permitted to extend beyond existing contracts to include anticipated contract periods, thereby providing a significant earnings management opportunity by permitting the entity to either assert or not assert that an existing contract will be renewed.
- (b) Second, under the proposed guidance, variable consideration should be recognized only when it is reasonably assured, a term that suggests that a recognition threshold must be exceeded for recognition to occur. No guidance is provided in the proposed Update that specifies the threshold that must be exceeded for revenue to be considered reasonably assured. Is that threshold consistent with the high confidence threshold used by accounting firms when implementing the concept of reasonable assurance in the U.S. auditing literature, or if no threshold need be met, should not a better term be used?
- (c) Third, additional guidance is needed for determining when an expected value or most likely amount should be used to estimate

variable consideration in a transaction price. The proposed model provides a measurement objective and then suggests possible circumstances in which these alternative measurement methods may (and by implication may not) be used. This challenges the ability of auditors to determine whether the appropriate method to meet the measurement objective has been selected.

Conclusion

BC377. Mr. Linsmeier believes that many of the issues he has identified have arisen in an effort to minimize differences with current practice by including in the proposed standard past guidance in existing literature. Mr. Linsmeier believes that the proposed model for revenue recognition could be made suitable for issuance if it were to eliminate specific guidance that is inconsistent or contradictory and, instead, rely on core principles without exception to provide a consistent framework for recognizing revenue. In addition, Mr. Linsmeier believes that to best capture the economics of revenue transactions, the revenue recognition standard also must address cost recognition comprehensively, including the recognition of losses when costs are expected to exceed revenues in onerous contracts. Finally, efforts need be undertaken to ensure that the guidance in the proposed standard are made operable and auditable by specifying the conditions that must be met when key judgments are required.

The following alternative view expressed by an IASB Board member is not part of the FASB's Exposure Draft but has been included for informational purposes.

BC378. Mr. Engström voted against publication of the Exposure Draft.

BC379. Mr. Engström strongly supports the objective of taking a step towards global convergence by developing a common revenue standard for IFRSs and U.S. GAAP. He also strongly supports the core principle proposed in paragraph 4 of the Exposure Draft and he supports the proposed requirements that would give effect to that principle. However, Mr. Engström is concerned about the extent of the proposed disclosure requirements in the Exposure Draft. Mr. Engström questions whether the benefits to users of the resulting disclosures would justify the costs that preparers would incur to provide those disclosures.

BC380. Mr. Engström's decision to vote against publication is triggered by the proposal to amend IAS 34, *Interim Financial Reporting*, to specify that an entity would be required to provide in its interim financial report some of the disclosures about revenue and contracts with customers

proposed for annual financial statements. Mr. Engström believes that it is inappropriate to require such disclosures in interim financial reports without undertaking a holistic review of IAS 34.

Amendments to the *FASB Accounting Standards Codification*[®]

During the four-month comment period ending March 13, 2012, the FASB will issue for public comment the proposed amendments to the *FASB Accounting Standards Codification*[®]. Those proposed amendments will be available for public comment for a minimum of 60 days.

Amendments to the XBRL Taxonomy

The FASB will expose for public comment the proposed changes to the U.S. GAAP Financial Reporting Taxonomy (UGT) that would be required were the provisions of this Exposure Draft finalized as proposed. The proposed changes to the UGT will be issued at the same time as the proposed amendments to the *FASB Accounting Standards Codification*[®].

The FASB will alert the public of the availability of proposed changes to the UGT (and the deadline for comment) through an announcement on its website and in its *Action Alert* email service.

Appendix A: Glossary

Defined terms to be added to the Master Glossary include the following:

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|---|---|
| Contract | An agreement between two or more parties that creates enforceable rights and obligations. |
| Contract asset | An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when that right is conditioned on something other than the passage of time (for example, the entity's future performance). |
| Contract liability | An entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer. |
| Customer | A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities. |
| Performance obligation | A promise in a contract with a customer to transfer a good or service to the customer. |
| Revenue | Inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations. |
| Standalone selling price (of a good or service) | The price at which an entity would sell a promised good or service separately to a customer. |
| Transaction price (for a contract with a customer) | The amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, sales taxes). |

Appendix B: Summary of Changes from the 2010 Proposed Update

The following table summarizes the changes to the Boards' June 2010 proposals in response to feedback received:

| Steps to Apply the Proposals | Description of Changes to the Proposals |
|---|---|
| Step 1: Identify the contract(s) with the customer | <ul style="list-style-type: none"> • Changed the proposed <i>indicators</i> on combining contracts to <i>criteria</i>. The criteria are limited to contracts that are entered into at or near the same time with the same customer (or related parties). Added a criterion for goods or services across contracts that are a single performance obligation. • Eliminated the proposal on contract segmentation (but moved the principle to Step 4 on allocating the transaction price). • Revised the proposal on contract modifications to reduce the instances in which an entity would account for a modification on a cumulative catch-up basis. |
| Step 2: Identify the separate performance obligations in the contract | <ul style="list-style-type: none"> • Retained the definition of a <i>performance obligation</i> subject to the deletion of the term <i>enforceable</i> (to clarify the June 2010 proposals). • Clarified the proposals for identifying separate performance obligations (distinct goods or services) mainly by moving the guidance on a significant contract management service from the implementation guidance/basis into the proposed standard and by deleting reference to <i>distinct profit margin</i> in the proposed standard. |
| Step 3: Determine the transaction price | <ul style="list-style-type: none"> • Modified the definition of <i>transaction price</i> to refer to the amount to which the entity expects to be <i>entitled</i> rather than the expected amount to be <i>received</i>. |

| Steps to Apply the Proposals | Description of Changes to the Proposals |
|--|---|
| | <ul style="list-style-type: none"> • Modified the proposals on determining the transaction price as follows: <ul style="list-style-type: none"> ○ Collectibility: credit risk no longer included in the transaction price. Accounted for similarly to current practice (except for the presentation adjacent to revenue). ○ Time value of money: added a one-year practical expedient and clarified when a financing component is significant. ○ Variable consideration: either an expected value or a most likely amount is required (to simplify the proposals, which would have required a probability-weighted estimate in all cases). |
| Step 4: Allocate the transaction price | <ul style="list-style-type: none"> • Clarified that it may be appropriate for an entity to estimate a selling price using a residual approach if the price of a good or service is highly variable or uncertain. • Added guidance on when it is appropriate to restrict allocations of discounts, contingent payments, and changes in the transaction price to only some promised goods or services. That guidance uses the 2010 proposed Update's principle of price independence (from contract segmentation) but has specific criteria to clarify when goods or services are priced independently (that is, the payment terms relate to the particular good or service and the amount is consistent with the objective of allocating the transaction price). |
| Step 5: Recognize revenue when a performance obligation is satisfied | <ul style="list-style-type: none"> • Added <i>risks and rewards of ownership</i> as an indicator of when control is transferred at a point in time. • Added criteria for determining when a performance obligation is satisfied over time. • Retained the objective of measuring progress toward completion of a performance obligation, but: <ul style="list-style-type: none"> ○ Clarified the discussion of alternative |

| Steps to Apply the Proposals | Description of Changes to the Proposals |
|------------------------------|---|
| | <p>methods (that is, output and input methods)</p> <ul style="list-style-type: none"> ○ Added guidance on uninstalled materials ○ Added guidance on reasonable measures of progress ○ Clarified the meaning of <i>abnormal costs</i>. <ul style="list-style-type: none"> ● Changed the proposed constraint from an entity's <i>reasonable estimate</i> of the transaction price to the entity being <i>reasonably assured</i> to be entitled to the amount of consideration recognized as revenue to date. No change made to the factors to consider when making that determination other than clarifying that an entity is not reasonably assured to be entitled to a sales-based royalty amount until the occurrence of the event that makes the payment due. |
| Other Issues | |
| Warranties | <ul style="list-style-type: none"> ● Revised the proposed guidance to require an entity to account for some warranties as a cost accrual, which is more consistent with current practice. |
| Licenses and rights to use | <ul style="list-style-type: none"> ● Eliminated the distinction between nonexclusive and exclusive licenses. All rights to use are transferred at a point in time (subject to the separation criteria and the proposal to constrain cumulative revenue recognized to the amount to which the entity is reasonably assured to be entitled). |
| Onerous test | <ul style="list-style-type: none"> ● Modified the scope of the test to a performance obligation that an entity satisfies over a period of time greater than one year. ● Added guidance on which costs to include when performing the test (an entity would use the lower of the direct costs to satisfy the performance obligation and the amount the entity would pay to exit the performance obligation, if permitted under the contract). |

| Steps to Apply the Proposals | Description of Changes to the Proposals |
|--------------------------------|--|
| | <ul style="list-style-type: none"> • Provided an exemption from recognizing a liability for an onerous performance obligation for not-for-profit entities if the purpose of the contract is to provide a social or charitable benefit. |
| Acquisition costs | <ul style="list-style-type: none"> • Changed the guidance in the 2010 proposed Update so that the incremental costs of obtaining the contract (for example, sales commissions) would be recognized as an asset. As a practical expedient, permitted the option to recognize acquisition costs as an expense if the contract is one year or less. • Added disclosure requirements. |
| Fulfillment costs | <ul style="list-style-type: none"> • Clarified how an entity would amortize the asset recognized from fulfillment costs (that is, the asset would be amortized in accordance with the pattern of transfer of goods or services to which the asset relates, which might be provided in specific anticipated contracts). • Clarified the guidance on how an entity would test the asset for impairment (that is, revised the wording for precontract costs and specified whether a reversal of an impairment is required). • Added disclosure requirements. • Clarified the scope of the cost guidance developed as part of the revenue project. |
| Sale and repurchase agreements | <ul style="list-style-type: none"> • Added guidance to specify that an entity should account for a sale with a put option as a lease if the customer has a significant economic incentive to exercise the option. |
| Disclosures | <ul style="list-style-type: none"> • Limited the instances in which an entity would provide a maturity analysis of remaining performance obligations. • Provided exemption from some disclosure requirements for nonpublic entities. |
| Breakage | <ul style="list-style-type: none"> • Added guidance on how to apply the model when the customer purchases a material right but chooses not to fully exercise that right (that is, breakage). That guidance is consistent with the 2010 proposed Update's |

| Steps to Apply the Proposals | Description of Changes to the Proposals |
|-------------------------------------|--|
| | guidance in the example on customer loyalty points. |
| Transition | <ul style="list-style-type: none"> • Provided some specified reliefs for transitioning to the proposed standard on a retrospective basis. |