

MAZARS INSIGHT

IFRS 15: KEY POINTS OF THE REVENUE RECOGNITION STANDARD IN 100 QUESTIONS & ANSWERS

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INTRODUCTION

IFRS 15 – *Revenue from Contracts with Customers* is mandatory for financial statements prepared in accordance with IFRS from 1 January 2018.

The Standard was published in May 2014 and amended in April 2016 in order to clarify certain issues. It replaces the previous revenue recognition Standards, namely IAS 11 – *Construction Contracts* and IAS 18 – *Revenue*, as well as the related Interpretations.

IFRS 15 introduces a single five-step revenue recognition model that is applicable to all types of contracts with customers in all sectors, resulting in improved comparability of financial statements. It also covers the accounting for licences.

The core principle of IFRS 15 is that revenue recognition should 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. The Standard uses the concept of the transfer of control to the customer to determine when goods or services are transferred. The transfer of control may occur at a point in time (e.g. when a good is delivered) or over time (e.g. as a service is provided or a good is constructed).

Implementation of IFRS 15 may be complex, as it requires an entity to understand the intricacies of numerous different concepts (control, performance obligations, stand-alone selling price, costs incurred to fulfil a contract, etc.), comply with the principles set out in each step of the revenue recognition model, and make frequent use of judgement while taking account of the facts and circumstances of each specific situation.

In addition to the revenue recognition issues, entities must also pay close attention to the disclosures in the notes to the financial statements, in order to ensure that they comply with the requirements of the Standard.

This guidance in 100 questions and answers is meant to serve as a useful tool for as many stakeholders as possible, providing clarity and insight on the challenging issues at stake when implementing IFRS 15. It does not aim to cover every possible situation that may be encountered in practice, but many topics are examined in detail.



10 KEY POINTS TO REMEMBER

1. IFRS 15 applies to all sectors and all types of sales contracts with customers (e.g. sales of goods or services, the provision of licences of intellectual property, construction contracts, etc.).
2. Revenue recognition requires analysis of contracts with customers using a five-step model.
3. The concepts of “contract” and “customer” are defined in the Standard. Thus, identifying a contract for revenue recognition purposes requires an entity to apply the principles specified in the Standard which may in some cases require the entity to combine several legal contracts, and which provide a specific framework for accounting for contract modifications.
4. A contract with a customer, as defined in IFRS 15, may contain several components to be recognised separately, called “performance obligations”. Each separate performance obligation within a contract has its own margin and pattern of recognition.
5. Revenue from a contract is measured at an amount that reflects the consideration to which the entity expects to be entitled in exchange for the goods or services sold, without taking account of the customer’s credit risk (collectability of an amount of consideration must however be deemed probable for revenue to be recognised for). This measurement takes account of variable consideration (although an entity should recognise revenue only if it is highly probable that it will not have to subsequently recognise a significant revenue reversal), significant financing components (whether the entity is financing its customer or vice versa), non-cash consideration, and consideration payable to customers.
6. Revenue allocated to each performance obligation in accordance with the specific requirements set out in IFRS 15 (i.e. on a relative stand-alone selling price basis) is recognised when (or as) control of the good or service is transferred to the customer. Thus, for revenue to be recognised over time, the entity must have first demonstrated that control of the good or service is transferred over time. Otherwise, revenue allocated to the performance obligation is recognised at a point in time.
7. IFRS 15 also addresses the accounting for costs relating to contracts with customers (i.e. costs to obtain or fulfil contracts). Capitalisation of those costs (and subsequently their amortisation) occurs only if certain conditions are met; an entity is not permitted to capitalise costs merely to smooth margins.
8. IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets* shall be used to determine whether a contract with a customer is onerous (i.e. the assessment is made at contract level, not at performance obligation level).
9. IFRS 15 includes specific requirements on disclosures in the notes, relating to profit or loss, the balance sheet and off-balance sheet items (i.e. revenue yet to be recognised from contracts with customers – similar to the concept of “backlog”). In particular, the Standard requires disclosures on significant judgements made by the entity.
10. The IASB has worked jointly with the FASB, the US standard-setter, to develop IFRS 15. However, this has not resulted in perfect convergence of both accounting frameworks.

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OVERVIEW

[QUESTIONS 1 TO 8]



1. Does IFRS 15 apply to all sectors and all types of sales contracts with customers?

[\[IFRS 15.3\]](#)

IFRS 15 applies to all sectors and all types of sales contracts with customers. The principle of revenue recognition at the point of transfer of control (cf. **question 5**) and the five-step revenue recognition model (cf. **question 8**) apply to all contracts with customers that fall within the scope of the Standard (cf. **question 2**).

Each sector shall apply the principles set out in IFRS 15 consistently to contracts with similar characteristics. An entity must make judgements based on the facts and circumstances at various steps of the model, which may result in different accounting treatments for different contracts.

2. What is the scope of IFRS 15?

[\[IFRS 15.5\]](#)

IFRS 15 shall be applied to all contracts with customers (cf. **question 3**), with the exception of:

- a) leases within the scope of IFRS 16 – *Leases*;
- b) insurance contracts within the scope of IFRS 4 – *Insurance Contracts*;
- c) financial instruments and other contractual rights or obligations within the scope of IFRS 9 – *Financial Instruments*, IFRS 10 – *Consolidated Financial Statements*, IFRS 11 – *Joint Arrangements*, IAS 27 – *Separate Financial Statements* and IAS 28 – *Investments in Associates and Joint Ventures*;
- d) non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers. For example, IFRS 15 would not apply to a contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.

3. How does IFRS 15 define a “customer”?

[\[IFRS 15.6\]](#)

IFRS 15 shall be applied to a contract within the scope of the Standard (cf. **question 2**) only if the other party to the contract is a customer.

IFRS 15 defines a customer as a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration. The counterparty to the contract would not be a customer if, for example, it has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain an output of the entity’s ordinary activities.

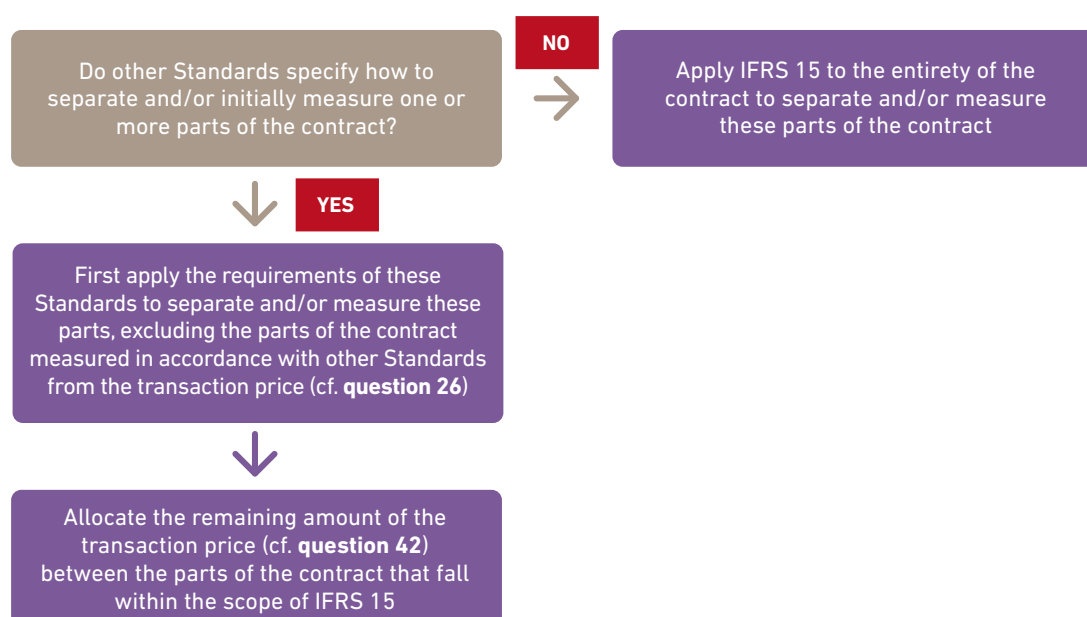


4. What is the accounting treatment for contracts that fall within the scope of several Standards, including IFRS 15?

[IFRS 15.7]

The accounting treatment for a contract that falls within the scope of several different Standards, including IFRS 15, depends on whether the other Standards specify how to separate and/or measure one or more parts of the contract.

Figure 1



5. What is the core principle of IFRS 15?

[IFRS 15.2]

The core principle of IFRS 15 is that an entity shall recognise revenue in such a way as to show when promised goods or services are transferred to customers, and the amount of consideration to which the entity expects to be entitled in exchange for those goods or services.

Thus, an entity shall recognise revenue when (or as) it satisfies a performance obligation (cf. **question 16**) by transferring a promised good or service, i.e. an asset, to the customer¹. An asset is transferred when (or as) the customer obtains control of the asset (cf. **question 51**).

The entity must take various aspects into account when measuring the amount of consideration to which it expects to be entitled in exchange for the promised goods or services (cf. **question 27**). However, this measurement shall not take account of the customer's credit risk. This risk is taken into account through one of the criteria listed in step 1, which are used to determine when a contract with a customer exists (cf. **question 10**).

¹ It should be noted that many services are not recognised as assets as they are simultaneously received and consumed by the customer.

6. Does IFRS 15 permit any practical expedients?

[IFRS 15.3]

Yes, IFRS 15 permits several practical expedients. They fall into two categories:

- practical expedients on transition (cf. **question 92**);
- practical expedients permitted throughout application of the Standard, which relate to:
 - > using a portfolio approach, under certain conditions (cf. **question 7**);
 - > exemption from the requirement to adjust revenue for the effects of a significant financing component, in certain situations (cf. **question 33**);
 - > recognising revenue over time on the basis of amounts billed, subject to certain conditions (cf. **question 59**);
 - > recognising the incremental costs of obtaining a contract as an expense (when the capitalisation criteria are met) at the point at which they are incurred, subject to certain conditions (cf. **question 64**);
 - > exemption from the requirement to disclose in the notes the amount of the transaction price allocated to unsatisfied performance obligations, subject to certain conditions (cf. **question 88**).

If an entity is applying any practical expedients, it shall apply them consistently to contracts with similar characteristics and in similar circumstances.

Furthermore, if an entity applies the practical expedients relating to the existence of a financing component or the incremental costs of obtaining a contract, it shall disclose this fact in the notes (cf. **question 86**).

7. Can IFRS 15 be applied to a portfolio of contracts?

[IFRS 15.4]

The requirements of IFRS 15 are applicable to contracts on an individual basis, but as a practical expedient, the Standard may be applied to a portfolio of contracts:

- with similar characteristics, if
- the entity expects that the effects of applying IFRS 15 to the portfolio of contracts would not differ materially from applying the requirements of the Standard to the individual contracts.

In July 2015, the TRG (cf. **question 98**) indicated that if an entity considers evidence from other similar contracts when estimating variable consideration using the expected value method (cf. **question 28**), this does not necessarily mean that it is applying (and thus must justify) the portfolio method.



8. What are the main steps of IFRS 15 implementation?

The introduction to IFRS 15 sets out how the revenue recognition principle (cf. **question 5**) shall be implemented in practice. This is explained in a five-step model.

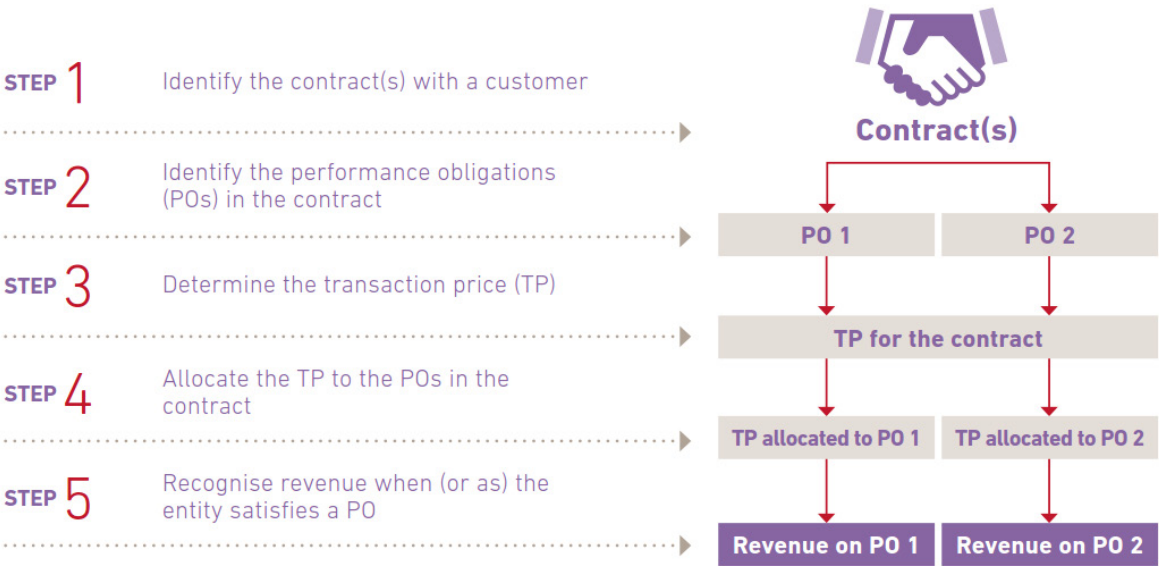


The five steps are not explicitly stated in the main text of the Standard. Moreover, the Standard does not follow the order of the steps set out in the model. It is also worth noting that an entity may often need to go back and forth between the different steps of the model, meaning that correct implementation of the principles in the Standards may involve deviating from the order set out in the model. For example, an entity will need to determine the pattern of revenue recognition for each item in a group of similar items – in accordance with step 5 of the model – in order to determine whether the group constitutes a single performance obligation to deliver a series of distinct similar goods or services – in accordance with step 2 of the model (cf. **question 21**).

The five steps of the revenue recognition model are as follows:

- **step 1: identify the contract(s) with a customer** (cf. **questions 9 to 15**): IFRS 15 defines a contract with a customer and sets out the criteria for identifying whether a contract should be accounted for in accordance with IFRS 15. In some cases, a contract shall be combined with one or more other contracts. IFRS 15 also specifies the accounting treatment for contract modifications. Thus, this step involves identifying the unit of account to which the principles set out in the Standard should be applied both in terms of revenue recognition and of the information to be provided in the notes regarding the transaction price allocated to unsatisfied performance obligations (concept similar to “backlog” – cf. **question 88**);
- **step 2: identify the performance obligations in the contract** (cf. **questions 16 to 25**): when a contract (or a group of contracts) involves the transfer of several goods or services to a customer, IFRS 15 stipulates the criteria that an entity shall apply to determine whether the goods or services are distinct and whether each constitutes a separate performance obligation;
- **step 3: determine the transaction price for the contract** (cf. **questions 26 to 40**): IFRS 15 stipulates the elements that shall be taken into account when determining the total transaction price for the contract (e.g. variable amounts relating to the contract) as well as how to measure them;
- **step 4: allocate the transaction price to the performance obligations in the contract** (cf. **questions 41 to 49**): IFRS 15 explains how to allocate the transaction price determined in step 3 to the performance obligations identified in step 2 (notably in situations where a rebate has been given to the customer, or where the consideration involves a variable amount). In this step, each performance obligation in the contract is thus being allocated a particular amount of revenue and margin;
- **step 5: recognise revenue when (or as) the entity satisfies a performance obligation** (cf. **questions 50 to 61**): once the amount of revenue to be recognised for each performance obligation has been determined in accordance with step 4, this final step requires the entity to identify the point at which control of the underlying goods or services is transferred to the customer. In practice, some performance obligations within a contract may be satisfied over time, in which case revenue is also recognised over time, whereas other performance obligations are satisfied at a point in time and revenue is thus recognised at this point in time.

Figure 2



STEP 1: IDENTIFICATION OF THE CONTRACT

[QUESTIONS 9 TO 15]



9. Step 1: how does IFRS 15 define a contract with a customer?

[IFRS 15.10-12]

IFRS 15 defines a contract as an agreement between two or more parties that creates rights and obligations that are enforceable (i.e. that are a matter of law, and could e.g. be enforced by a court).

When assessing enforceability, an entity shall take into account the practices and processes that are specific to the entity and to the sectors within which it operates, as well as the applicable laws in the relevant jurisdiction(s).

IFRS 15 also stipulates that 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 or 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.

A contract for which an entity has received a significant non-refundable upfront fee is not a wholly unperformed contract (i.e. it creates enforceable rights and obligations).



In some industries, it is common for an entity to sign a framework agreement (or master agreement) with a customer, which stipulates the main principles governing the relationship between the two parties. These agreements do not usually stipulate the amounts to be purchased by the customer; these are usually stipulated in separate purchase orders at a later date. Thus, the entity must pay close attention to the nature of the reciprocal rights and obligations in order to determine which agreement constitutes a contract as defined in IFRS 15.

Furthermore, an option to acquire additional goods or services does not create enforceable rights and obligations as the customer can decide whether or not to acquire these goods and services without facing any negative financial consequences if it decides not to exercise the option (cf. **question 71**). Similarly, particular attention should be paid to early termination clauses that could affect the scope of the contract, in terms of either its duration or the quantities acquired. Thus, if the customer can terminate the contract without having to pay a substantive penalty for the goods or services not yet provided, these goods or services should be treated as optional. The entity must use its judgement and take account of all relevant facts and circumstances when assessing whether a penalty is substantive.

In October 2014, the TRG (cf. **question 98**) discussed how early termination clauses should be taken into account when determining the duration of a contract. The TRG approved a number of examples drawn up by the staff. Thus, if a contract covers a fixed period, but can be terminated at any time by either party without compensating the other party, it should be concluded that the contract has no set duration and has to be treated as a monthly renewable contract. In other situations where a contract covers a fixed period and can be terminated by either party, but the customer would have to pay a substantial penalty to terminate the contract, the duration of the contract is the period covered by this penalty (i.e. the period for which the customer is effectively committed to the contract, as the penalty would in itself deter the entity from terminating the contract during this period). Lastly, if the customer can cancel future phases or batches without compensating the other party, provided that work relating to these goods or services has not yet begun, these phases or batches are optional.

The TRG continued its discussions on the subject in November 2015, stating that if only the customer has the right to terminate the contract and must pay a substantive penalty if it does so, a contract exists as defined in accordance with IFRS 15.



The definition of a contract is supplemented by conditions (cf. **question 10**) which must all be fulfilled in order to apply the accounting model of IFRS 15.

10. Step 1: what criteria must be met in order to recognise a contract with a customer?

[IFRS 15.9 & IFRS 15.13-14]

The IASB decided to complement the definition of a contract (cf. **question 9**) by specifying criteria that must all be met in order for the contract to be accounted for in accordance with the principles set out in IFRS 15:

- a) 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;
- b) the entity can identify each party's rights regarding the goods or services to be transferred;
- c) the entity can identify the payment terms for the goods or services to be transferred;
- d) the contract has commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and
- e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (cf. **question 11**). In practice, the entity shall assess whether it is more likely than not to collect the consideration to which it will be entitled.

These criteria shall be assessed at contract inception. If a contract with a customer does not meet the criteria above, it shall be assessed on an ongoing basis in order to determine whether it meets the criteria subsequently. If a contract does not meet these criteria, revenue may only be recognised under very specific circumstances (cf. **question 12**). The identification of when these criteria are met also has consequences on the disclosures to be provided in the notes. Indeed, IFRS 15 requires disclosure of the transaction price allocated to unsatisfied performance obligations (cf. **question 88**). In other words, a contract identified under step 1 of IFRS 15 is taken into account to determine the "backlog" disclosed in the notes.

If a contract does meet the criteria, there is no need to reassess it unless there is an indication of a significant change in facts and circumstances. For example, IFRS 15 states that if a customer's ability to pay the consideration deteriorates significantly, an entity would reassess whether it is probable that the entity will collect the consideration to which it will be entitled in exchange for the remaining goods or services that will be transferred to the customer (cf. **question 11**). If it is no longer probable, no further revenue may be recognised (cf. **question 12** for the possibility of recognising additional revenue based on the cash received). In practice, an entity will need to use its judgement in this situation.

11. Step 1: to what extent is credit risk taken into account in IFRS 15?

[IFRS 15.9, IFRS 15.64 & IFRS 15.102]

One of the criteria used in IFRS 15 to determine whether a contract shall give rise to revenue recognition relates to the customer's credit risk (cf. **question 10**).

As we have seen, IFRS 15 requires an entity to assess whether it is probable (i.e. more likely than not) that the entity will collect the consideration to which it is entitled in exchange for the goods or services that will be transferred to the customer.

In evaluating whether collectability of an amount of consideration is probable, the entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due.

The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity has implicitly decided to offer the customer a price concession. For example, a price concession may be offered to a customer with a high level of credit risk because the supplier wants to break into a new market in a particular country. In this case, the collectability criterion is met and the contract will give rise to revenue recognition, provided that it also meets the other criteria (cf. **question 10**).

At contract inception, significant use of judgement may be required to distinguish between an implicit price concession and a significant credit risk. All relevant facts and circumstances must be taken into account in this analysis.

It should be noted that, in practice, the IASB does not expect that many contracts will fail to meet the customer credit risk criterion. This risk may remain purely theoretical if the entity is able to manage its exposure to the contract by putting in place preventive measures (e.g. by scheduling regular milestone payments, in advance of the transfer of goods or services).

When determining the transaction price for the contract (step 3), the customer's credit risk is not taken into account (conversely, an implicit price concession is taken into account). If contract assets or receivables relating to contracts with customers are impaired (as defined in IFRS 9, using the expected loss model – cf. **questions 82** and **84**), the impairment losses shall either be recognised separately in the balance sheet, or disclosed separately in the notes (cf. **question 86**).



12. Step 1: what happens if, at a given date, the contract does not meet all the criteria for recognition and the entity receives consideration from the customer?

[IFRS 15.15-16]

If a contract with a customer does not meet the criteria for recognition under IFRS 15 (cf. **question 10**) and the entity receives consideration from this customer, the entity shall recognise the consideration as revenue only if one of the following events has occurred:

- a) the entity has no remaining obligations to transfer goods or services to the customer and all, or substantially all, of the consideration promised by the customer has been received by the entity and is non-refundable;
- b) the contract has been terminated and the consideration received from the customer is non-refundable.

However, in the first situation described above, the entity should also take account of its customary business practices, which in certain situations may permit it to cease providing goods or services to the customer (e.g. in the case of an X-month subscription contract which is billed on a monthly basis) or to demand upfront payments. Any consideration that has already been received in exchange for distinct goods or services that have already been transferred to the customer may then be recognised as revenue, even before the end of the contract. In practice, this means that an entity only needs to assess the collectability of the transaction price for goods and services that are yet to be transferred, if they are distinct from those already transferred. This clarification is stated explicitly in Topic 606 (following an amendment to the Standard) but not in IFRS 15, although some further explanation is provided in the Basis for Conclusions – cf. IFRS 15.BC46F-46H).

The entity shall recognise the consideration received from a customer as a liability until one of the events described above occurs or until the criteria set out in IFRS 15 are subsequently met.

Thus, IFRS 15 does not permit revenue to be recognised for consideration already received if it is not probable that the full amounts due under the contract will be collected (for further details in order to assess the fulfilment of this criterion, cf. **question 11**).

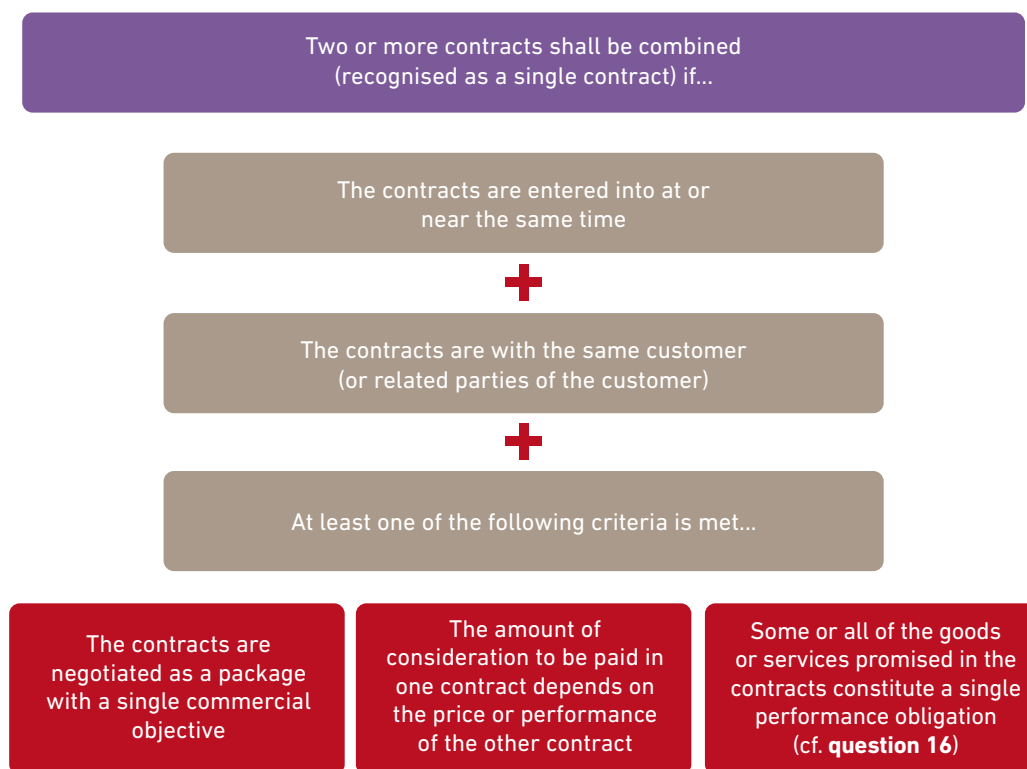
Depending on the facts and circumstances relating to the contract, the liability recognised represents the entity's obligation to either transfer goods or services in the future or refund the consideration received.

13. Step 1: under what circumstances shall an entity combine contracts?

[IFRS 15.17]

An entity shall combine contracts if the criteria set out in IFRS 15 are met.

Figure 3



The Standard does not specify the maximum time period that qualifies as “near the same time” and that would thus require the contracts to be combined if the other criteria are met. An entity must therefore use its judgement if two or more contracts are not entered into on the same date. The longer the time period between the dates at which the contracts are entered into, the more probable it is that the economic circumstances affecting the contracts will have changed.

14. Step 1: what is a contract modification?

[IFRS 15.18-19]

A contract modification is a change in the scope and/or price of a contract that is approved by the parties to the contract. A contract modification:

- creates new enforceable rights and obligations for the parties to the contract; or
- changes the existing enforceable rights and obligations.

A modification could be approved by the parties to the contract in writing (e.g. via a contract amendment, a change order, i.e. a modification at the customer’s request, or a claim, i.e. a modification at the supplier’s request), by oral agreement or implied by customary business practices.



If the parties to the contract have not approved a contract modification, the entity shall continue to apply IFRS 15 to the existing contract until the contract modification is approved.

A contract modification may exist in the following situations:

- the parties to the contract have a dispute about the price and/or scope of the work to which the modification is related;
- the parties have approved a change in the scope of the contract but have not yet agreed the corresponding change in price.

In these situations, an entity may still have to recognise a contract modification if it determines that the new rights and obligations resulting from the modification are enforceable (for more details on the definition of this term, cf. **question 9**). When assessing whether the new rights and obligations are enforceable, the entity shall take account of the terms of the contract, as well as all relevant facts and circumstances and other evidence (e.g. customary business practices, jurisprudence, etc.). The judgement applied may be significant.

If the parties to a contract have approved a change in the scope of the contract but have not yet agreed the corresponding change in price, the entity shall estimate this price in accordance with the requirements of IFRS 15 on estimating variable consideration and on constraining estimates of variable consideration (cf. **questions 28** and **29**).

Example 1

An entity enters into a contract with a customer to develop and build a specialised piece of equipment. The customer provides the entity with the input data required for development studies. The contract stipulates that any changes to development resulting from a change in the input data (e.g. as a result of changes in the regulatory framework applicable to the customer) gives the entity a right to additional consideration, calculated as cost plus a margin (i.e. the amount of additional costs incurred by the entity as a result of the change, plus a percentage reflecting the profit margin on similar contracts).

During the development phase, a change is made to the customer's regulatory framework, requiring an update to the input data. The customer produces the new data and asks the entity to make the necessary changes to the ongoing development studies. At the end of the development phase, the entity asks the customer for additional consideration to reflect the additional costs it has incurred as a result of the change. At first, the customer disputes the entity's calculation of the additional costs.

Question: may this change be considered as "approved" and recognised as a contract modification as defined in IFRS 15?

The entity considers the legal basis for its demand and concludes that under the terms of the contract, its demand is justified as it is based on enforceable rights.

Thus, even before the customer has formally agreed to the demand, the entity recognises it as a contract modification by updating the transaction price, while taking account of the constraint on estimates of variable consideration (i.e. it recognises the portion of additional revenue that it is highly probable will be collected – cf. **question 29**).

15. Step 1: how should a contract modification be accounted for?

[IFRS 15.20-21]

Some contract modifications are accounted for as a separate contract (i.e. distinct from the original contract) while others are accounted for as an adjustment to the original contract (either retrospectively or prospectively).

15.1 The contract modification is a separate contract

A contract modification is accounted for as a separate contract if the additional goods or services to be provided to the customer are distinct from those specified in the original contract (cf. **question 18**) and the transaction price for these additional goods or services reflects their stand-alone selling prices (cf. **question 43**).

In other words, modifications are accounted for as separate contracts if their economic terms are essentially the same as those of a new contract.

15.2 The contract modification is not a separate contract

If the contract modification does not meet the above criteria, it shall be accounted for as an adjustment to the original contract. Depending on the situation, such an adjustment may be accounted for either retrospectively (i.e. on a catch-up basis at the date of the contract modification) or prospectively:

- Retrospective adjustment:

The adjustment shall be accounted for retrospectively if the remaining goods or services are not distinct and, therefore, form part of a single performance obligation that is partially satisfied at the date of the contract modification. The modification shall be accounted for as if these data existed and were known from the outset. The cumulative retrospective impact of the modification on the transaction price, the associated costs and the measure of progress shall be accounted for all at once, as an adjustment to revenue and to the margin, at the date of the contract modification.

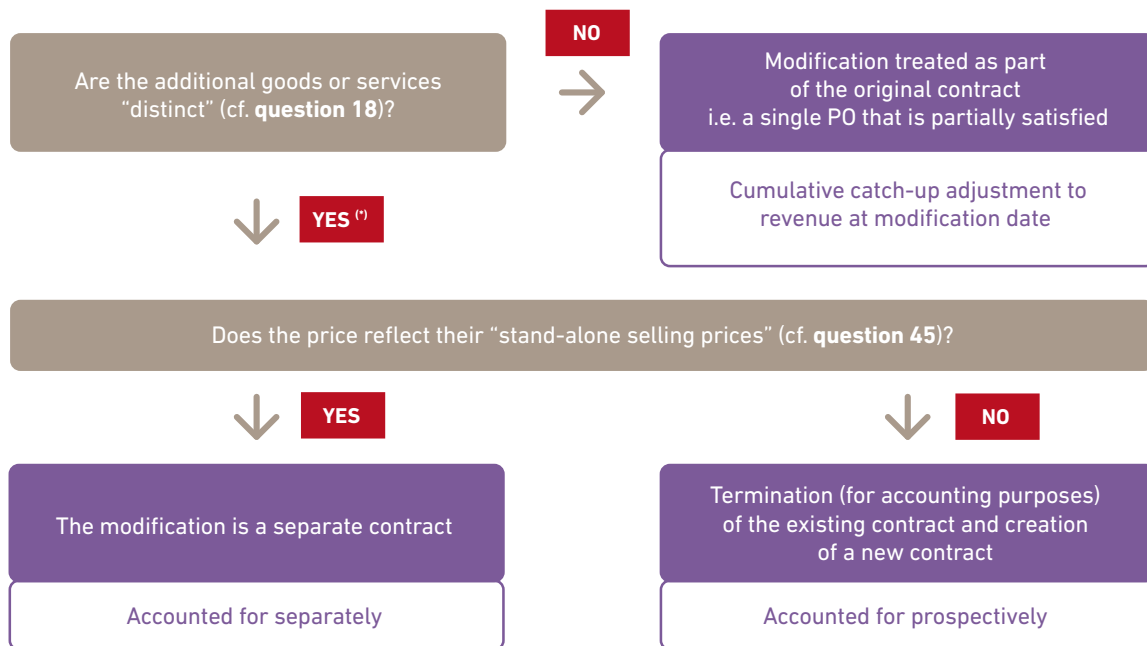
- Prospective adjustment:

The adjustment shall be accounted for prospectively if the modification relates to distinct goods and services that are provided at a price that does not reflect their stand-alone selling prices (cf. **question 43**). In this case, the modification shall be accounted for as if it were a termination of the existing contract and the creation of a new contract, which includes the remaining goods or services to be delivered under the original contract, plus the additional goods or services to be delivered as a result of the modification. The consideration for the new contract is thus the sum of the consideration not yet recognised as revenue from the original contract (i.e. for goods or services not yet delivered and for goods in production of which the customer has not yet obtained control) and the consideration promised as part of the contract modification.

Some contract modifications may be a combination of elements of both situations (i.e. part shall be accounted for retrospectively and part shall be accounted for prospectively).



Figure 4



^(*) Even if the modification relates to a PO that represents a "series" of distinct goods or services (cf. **question 21**).

Example 2

Case 1: the contract modification is a separate contract

Background

- An entity enters into a contract to provide 40 identical products for €100k each.
- The customer obtains control of each product at a specific point in time.
- The parties agree a contract amendment to provide an additional 12 identical products at a unit price that reflects the stand-alone selling price of the goods at the date when the amendment is entered into (€95k).
- To date, the entity has already delivered 30 products.

Question

- How should this contract modification be accounted for?

	Revenue already recognised at the date of the contract modification	Accounting impact of the contract modification
Original contract	• 30 products delivered • €3m revenue recognised (30 * €100k)	• 10 products still to be delivered • €1m to be recognised as revenue (10 * €100k)
Contract amendment		• 12 products still to be delivered • €1.1m to be recognised (12 * €95k)
Total	• 30 products delivered	• 10 products still to be delivered at a unit price of €100k and • 12 products still to be delivered at a unit price of €95k

Revenue recognised to date (unchanged)

Accounted for prospectively: recognition in revenue of €100k per product delivered under the terms of the original contract and €95k per product delivered under the amendment

Case 2: the contract modification is not a separate contract (prospective adjustment)

Background

- An entity enters into a contract to provide 120 identical products (unit price of €100k).
- The customer obtains control of each product at a specific point in time.
- The parties agree a contract amendment to provide an additional 30 identical products at an agreed price (€80k each). This price does not reflect the stand-alone selling price of each product.
- To date, the entity has already delivered 60 products.

Question

- How should this contract modification be accounted for?

	Revenue already recognised at the date of the contract modification	Accounting impact of the contract modification
Original contract	• 60 products delivered • Revenue recognised: €6m (60 * €100k)	• 60 products still to be delivered (unit price of €100k)
Contract amendment		• 30 products still to be delivered (unit price of €80k)
Total	• 60 products delivered	• 90 products still to be delivered at a unit price of €93,33k [(60*100) + (30*80)]/90

Revenue recognised to date (unchanged)

Accounted for prospectively: creation of a new contract with 90 products still to be delivered at a unit price of €93,33k (recognised as revenue on delivery of each product)



Case 3: the contract modification is not a separate contract (retrospective adjustment)

Background

- In year 1, an entity enters into a contract to construct a building on the customer's land.
- The entity determines that the contract is a PO satisfied over time.
- The measure of progress is based on the costs incurred to date (compared with total expected costs).
- At the start of year 2, the parties agree a contract amendment to reflect a change in the floor plan of the building.

Figures

	Original contract figures (year 1)	New contract figures (year 2)
Transaction price	€1,000k	€1,200k
Estimated costs	€700k	€820k
Margin	€300k (i.e. 30%)	€380k (i.e. 31.6%)

Question

- How should this contract modification be accounted for?

	Year 1	Adjustment to revenue already recognised at date of contract modification (start of year 2)
Costs incurred to date	€420k	€420k
Measure of progress	60% (420/700)	51.2% (420/820)
Revenue	€600k (60%*1,000)	+ €14,4k [(1,200*51.2%) – 600]





STEP 2: IDENTIFICATION OF THE PERFORMANCE OBLIGATIONS

[QUESTIONS 16 TO 25]



16. Step 2: how to identify the various performance obligations in a contract?

[IFRS 15.22 & IFRS 15.24-26]

If an entity is selling several goods or services within a single contract, IFRS 15 requires it to carry out the following assessment at contract inception, in order to identify the “performance obligations” (POs) in the contract.

The first step in identifying the performance obligations is to identify the various “promises” involved in the contract (e.g. sale of a product coupled with provision of an installation service). As it is not always easy to identify the goods or services transferred to the customer under the contract, this often requires the use of judgement:

- most promises are explicitly stated in the contract (sale of a finished or complex product, sale of one-off or ongoing provision of services, obligation to stand ready to provide a service, etc.). Although some goods or services are ancillary or are transferred as part of a specific marketing strategy, they still count as promised goods or services (unless their transfer occurs independently of the signing of the contract);
- however, other promises may be implicit, if the entity's customary business practices, published policies or specific statements lead the customer to expect at contract inception that the entity will provide it with a good or a service (e.g. a product guarantee in excess of the legal warranty, software updates when they become available, etc.);
- the contract may also include tasks that do not actually transfer any goods or services to the customer (e.g. administrative tasks at the start of a subscription service, studying a facility before carrying out technical work there, etc.).



IFRS 15 requires an entity to make a distinction between activities carried out by the entity that are directly involved in the transfer of a good or service to the customer, and activities that are necessary to fulfil the contract but that do not actually lead to the transfer of a good or service.

In particular, activities carried out at the start of a contract must be assessed to determine whether the costs should be recognised in the balance sheet as costs to fulfil the contract, or whether they are costs that contribute directly to the provision of a good or service because the customer obtains control of this good or service (cf. **question 17**). In some cases, a significant amount of expenses may be incurred without giving rise to revenue recognition. For example, an entity that provides maintenance services for an industrial facility that it has not built itself may incur significant costs to get to know the site in order to be in a position to carry out the maintenance procedures. In this example, all or some of these costs should meet the criteria set out in IFRS 15 in order to be recognised as an asset representing the costs incurred to fulfil a contract (cf. **question 64**).

An entity may need to make other judgements in order to identify the promises in the contract:

- distinguishing between warranties that provide the customer with an assurance that the product will function as the parties intended because it complies with agreed-upon specifications, and warranties that provide a service in addition to this assurance (cf. **question 23**);
- assessing activities carried out at contract inception that give rise to a non-refundable upfront fee to be paid by the customer (cf. **question 24**);
- assessing whether an option to acquire goods or services at a discount in the future provides the customer with a material right (cf. **question 71**).

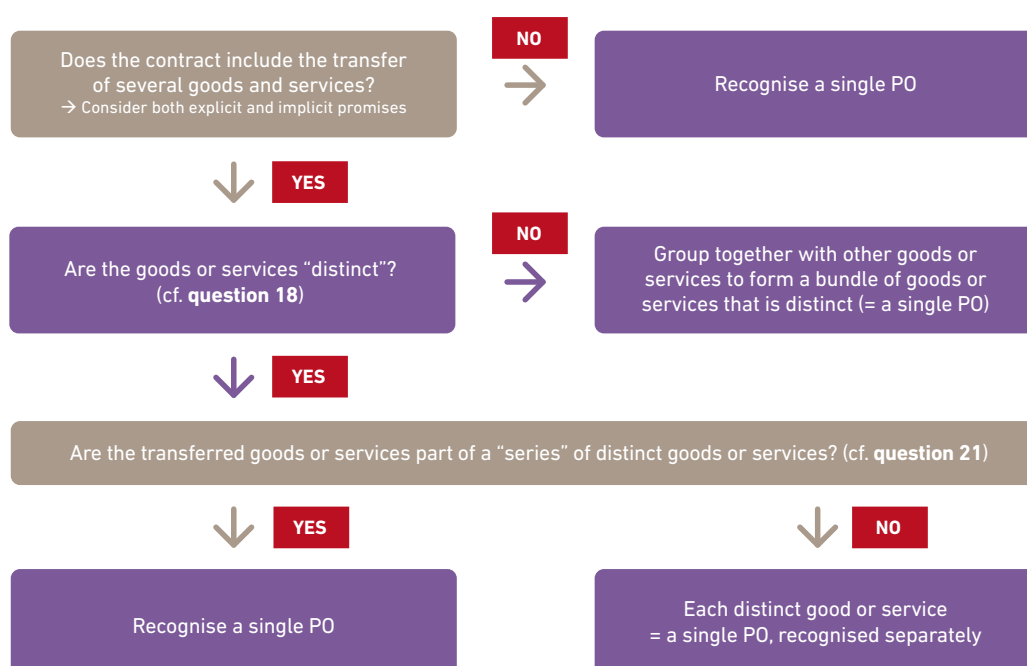


It should be noted that, generally speaking, the existence of an unconditional right to invoice for or collect consideration – as in the case of non-refundable upfront fees (cf. **question 24**) – does not affect the identification of performance obligations.

Once the goods and services promised in the contract have been identified, the entity shall identify the following as performance obligations:

- goods or services (or bundles of goods or services) that are “distinct” as defined in the Standard (cf. **question 18**); or
- a “series” of goods or services that, although distinct, constitute a single performance obligation because they are substantially the same and have the same pattern of transfer to the customer (cf. **question 21**).

Figure 5



In contrast to the equivalent US Topic, IFRS 15 has no recognition exemption for performance obligations that the entity deems to be immaterial at contract level. Thus, the materiality principle shall be applied at the level of the financial statements, as set out in IAS 8, to determine whether it is necessary to recognise certain performance obligations separately.



It is generally appropriate to set a threshold (a percentage of contract revenue) below which performance obligations may be deemed to be immaterial, meaning they do not need to be recognised separately. This would not contravene IAS 8. For example, this could be the case for relatively insignificant handling and transportation activities carried out after control of the good has been transferred to the customer. However, this should be assessed on a case-by-case basis.

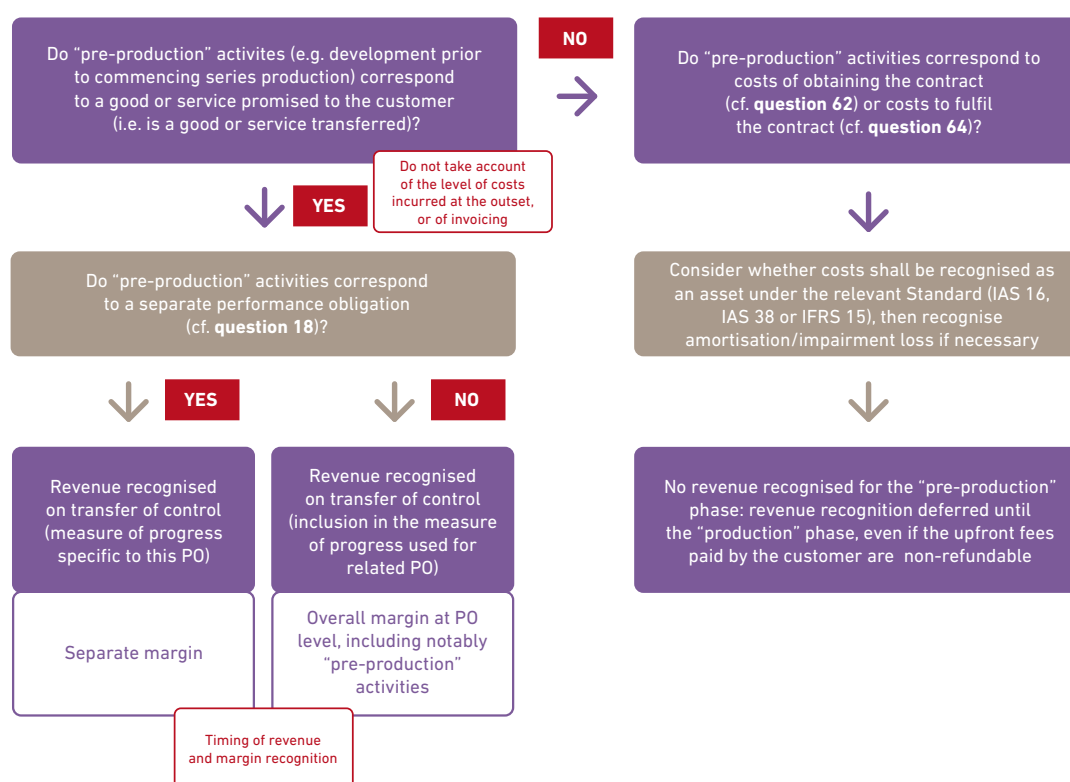


17. Step 2: how to account for setup activities?

Setup activities must be assessed to determine whether they result in revenue recognition or, in other cases, capitalisation of costs incurred. This depends on whether or not these activities correspond to a promise in the contract (cf. **question 16**).

This issue is particularly relevant to certain industries in which significant setup activities are required before production of specialised customer orders can commence (e.g. automotive or aeronautic suppliers) or before the entity can begin ongoing provision of tailored services (e.g. IT outsourcing).

Figure 6



Following its meeting in November 2015, the TRG (cf. **question 98**) stated that if an entity is having difficulty determining whether "pre-production" activities transfer a promised good or service to the customer, it is helpful to consider whether control of the good or service would be transferred.

The staff gave the following example in their agenda paper for the TRG: if an entity is required to perform engineering and development as part of developing, then producing, a new product for a customer and the customer will own the intellectual property (for example, patents) that results from those activities, then the entity likely would conclude that it is transferring control of that intellectual property to the customer. As a result, the engineering and development activities would be treated as a promise in the contract.

The TRG noted that such assessments could be complex and would require the use of judgement, taking all the facts and circumstances into account.

18. Step 2: how to determine whether goods or services (or bundles of goods or services) are “distinct”?

[\[IFRS 15.27 & IFRS 15.30\]](#)

Goods or services promised in a contract with a customer are distinct if both of the following criteria are met:

- **the good or service is “capable of being” distinct:** 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 (cf. **question 19**);
- **the good or service is distinct “within the context of the contract”:** the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (cf. **question 20**).

If a promised good or service is not distinct, an entity shall combine it with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, this will result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

19. Step 2: how to determine whether a promised good or service is distinct “in absolute terms” (1st criterion)?

[\[IFRS 15.28\]](#)

A promised good or service is capable of being distinct if the customer can use it, consume it, sell it for an amount that is greater than scrap value or otherwise hold it in a way that generates economic benefits.

In some cases, a customer may be able to benefit from a good or service on its own. For other goods or services, a customer may be able to benefit from the good or service only in conjunction with other readily available resources (i.e. a good or service that is sold separately by the entity or another entity, or a resource that the customer has already obtained itself or from the entity, including goods or services that the entity will have already transferred to the customer under the contract, or from other transactions or events).

The fact that the entity regularly sells a good or service separately would indicate that a customer can benefit from the good or service on its own or with other readily available resources.

In practice, this first criterion is usually met. Some examples of situations in which it is not met are as follows: the sale of a machine from which the customer can only benefit after an installation process that only the entity can provide; the sale of a piece of equipment from which the customer can only benefit following provision of a service that only the entity can provide (notably broadcasting of TV programmes via a TV decoder that is programmed to only receive signals from a particular operator); etc. In these situations, the customer cannot benefit from the machine or equipment on its own.

Finally, it should be noted that contractual limitations that might preclude the customer from obtaining readily available resources from a source other than the entity should not be taken into account in the assessment. For example, in the case of a bundle offer comprising a mobile phone and a subscription service, the fact that the customer is contractually obliged to purchase the subscription from the telecoms operator that has sold it the phone (for a minimum time period) does not mean that the phone is not capable of being distinct.

20. Step 2: how to determine whether a promised good or service is distinct “within the context of the contract” (2nd criterion)?

[IFRS 15.29]

The second criterion set out in IFRS 15 requires the entity to assess whether its promise is to transfer each of the goods or services individually or, instead, to transfer a combined item or items to which the promised goods or services are inputs. In practice, the entity must determine whether the transfer of goods and services is in effect the transfer of a combined output that is more than, or substantively different from, the sum of those individual goods and services promised in the contract.

If the promised goods or services are generally capable of being distinct (cf. **question 19**), it may be much more difficult to assess whether they are also distinct within the context of the contract. IFRS 15 is not aiming to divide up all contracts on a systematic basis. Rather, the entity will need to make significant use of judgement and take all relevant facts and circumstances into account when applying this second criterion.

To help entities make this judgement, IFRS 15 provides a list of indicators that might suggest, within the context of the contract, that two or more promises to transfer goods or services to a customer are not separately identifiable (and thus cannot be separate performance obligations):

- the entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represents the combined output or outputs for which the customer has contracted. In other words, the entity is using the goods or services as inputs to produce or deliver the combined output or outputs specified by the customer, which might include more than one phase, element or unit;
- one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract;
- the goods or services are highly interdependent or highly interrelated. In other words, each of the goods or services is significantly affected by one or more of the other goods or services in the contract. For example, in some cases, two or more goods or services are significantly affected by each other because the entity would not be able to fulfil its promise by transferring each of the goods or services independently.

This list of indicators (not criteria) is not exhaustive. Not all the indicators need to be present for an entity to conclude that its promises to transfer goods or services are not separately identifiable. Moreover, these factors may not be relevant in some situations, in which case an entity should focus on the principle set out in the Standard, which is to identify distinct goods and services in order to meet the objective of IFRS 15 (i.e. 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).



The assessment of whether a good or service is distinct within the context of the contract is based on the idea of “separable risks”. In this context, the individual goods or services in a bundle would not be distinct if the risk that an entity assumes to fulfil its obligation to transfer one of those promised goods or services to the customer is a risk that is inseparable from the risk relating to the transfer of the other promised goods or services in that bundle.

In practice, this means that IFRS 15 requires an entity to assess whether there is a significant “transformative relationship” between two or more items in the process of fulfilling the contract (e.g. an installation service that significantly modifies a machine in order to adapt it to the customer’s production line – the various activities involved in producing and installing the machine would constitute a single performance obligation) rather than simply a “functional relationship” (e.g. a printer cannot function without an ink cartridge). If there is a transformative relationship between two or more items, these items shall be treated as not distinct within the context of the contract.

In March 2018, the IFRS IC published three decisions relating to the application of IFRS 15 in the real estate sector. One of these provides a concrete example of how an entity should go about identifying the performance obligations in a contract.

Example 3

Fact pattern

- An entity enters into a contract for the provision of a new IT solution (ERP) that will replace the existing one.
- The contract is divided into 5 separate phases that are separately priced:
 1. Design of a customized IT solution (specifications according to the users’ needs and proposed architecture)
 2. Build of the ERP according to agreed specifications
 3. Implementation of the ERP in the customers’ IT environment (development of specific and complex interfaces for the ERP to be connected with other softwares)
 4. Data migration
 5. Testing and go-live

Question

Do the different phases constitute services that are distinct from the Build phase?

Phase	Capable of being distinct?	Distinct in the context of the contract?	Comments	Conclusion
1- Design	✓	✗	Even though design services may be provided stand alone, design is integrated in the combined output being the IT solution.	Together with Build
2- Build				Bundled PO
3- Implementation	✓	✗	Implementation implies customized developments to integrate the new solution in the customers’ IT environment. Part of the combined output.	Together with Build
4- Data Migration	✓	✓	Data Migration could have been done by the customer itself and does not modify the functionalities of the solution.	Separate PO
5- Testing	✓	✗	The testing phase may imply corrections / changes to the solution and is part of finalization of the combined output.	Together with Build



21. Step 2: in what situations would a series of distinct goods or services constitute a single performance obligation?

[IFRS 15.22(b) & IFRS 15.23]

A series of distinct goods or services (cf. **question 18**) would only constitute a single performance obligation if all of the following criteria are met:

- the distinct goods or services in the series are substantially the same; and
 The TRG (cf. **question 98**) clarified after its July 2015 meeting that, where a contract is for X increments of the same type of service (e.g. providing a daily hotel management service over a given time period), the activities carried out in each time increment do not need to be identical to the activities carried out previously in order to be treated as a series of distinct services “that are substantially the same”. In other words, the underlying activities carried out in order to provide the service may vary over the duration of the contract. Judgement on a case-by-case basis may be required in order to determine whether (or not) the above criterion is met.
- they have the same “pattern of transfer” to the customer, which under IFRS 15 means that both of the following criteria are met:
 - > each distinct good or service in the series would meet the criteria set out in IFRS 15 to be a performance obligation satisfied over time (cf. **question 52**); and
 - > the same method would be used to measure progress for each distinct good or service in the series (cf. **question 57**).

These criteria are included in order to simplify application of IFRS 15, but this does not mean that they are optional. As an example, they would apply equally to sales of multiple units of the same complex product, and to provision of repetitive services such as maintenance. It should also be noted that, if an entity applies the series guidance, the accounting consequences will not necessarily be identical to those resulting from the recognition of several distinct goods or services, when each of them constitutes a separate performance obligation (e.g. if there is a learning curve effect).

The TRG (cf. **question 98**) clarified following its March 2015 meeting that the series guidance could apply even if the goods or services in the series are not transferred consecutively (i.e. specific facts and circumstances may result in a delay between the transfer of some elements in the series).

In practice, the provisions for series of distinct goods and services have the following major consequences:

- it leads to smoothing the margin of the contract if there is a significant learning curve, as the transaction price is not allocated to each distinct element of the series (cf. **question 68**);
- an entity must account for any extension of the series (due to a contract amendment) either as a separate contract, or as a new contract including the remaining goods or services to be delivered under the original contract, plus the additional goods or service (cf. **question 15**). In practice, this implies that it will never be possible to have the same margin for both the original series and the amendment, as a retroactive adjustment to revenue is not permitted for amendments to contracts that relate to a series of distinct goods or services.



The guidance on series is different from the situation described in IFRS 15 example 10 (“Goods and services are not distinct”), case B (“Significant integration service”) (cf. paragraphs IE48A-IE48C). In this very specific case, an entity enters into a contract to set up a manufacturing process to produce multiple units of a complex, highly specialised device. Here, the entity’s promise is to establish and provide a service of producing the goods ordered by the customer in accordance with the customer’s specifications. In this example, according to the Standard, the contract only includes a single performance obligation for goods and services that are not distinct, covering all the activities to be carried out by the entity in order to fulfil the contract with the customer (i.e. procurement of raw materials, selection and management of sub-contractors, establishing a dedicated production line for the contract, production, assembly and testing). An important consequence of this is that if the series is extended (due to the exercise of an option to purchase additional goods), the contract modification shall be accounted for retrospectively (cf. **question 15**). It is important to note that this analysis is not transferable to situations in which the manufacturing process can be re-used for other customers, or for other contracts with the same customer.

We believe that, in practice, this example can only be applied by analogy in a very limited number of cases, for which significant use of judgement is required.

22. Step 2: what are the practical consequences of dividing a contract into several performance obligations?

Under IFRS 15, a performance obligation (cf. **question 16**) is the unit of account for revenue recognition. The Standard requires an entity to allocate the transaction price to each performance obligation in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer (cf. step 4 of the model, **question 41**). Thus, each performance obligation has its own portion of the revenue and the margin. This portion of revenue is recognised when the related performance obligation is satisfied (i.e. either over time or at a point in time, in accordance with step 5 of the model, cf. **question 50**).

However, the contract (potentially combined with other contracts, cf. **question 13**) remains the unit of account for assessing whether the transaction is onerous (cf. **question 69**).

In light of the above, and given the revenue recognition challenges under the IFRS 15 model, we believe that it is not necessary to identify separate performance obligations within a contract if:

- the pattern of transfer of control to the customer (over time or at a point in time) is similar, and the transfer is concurrent for each distinct good or service; and
- identifying a single performance obligation for distinct goods or services does not affect the entity’s financial reporting.



23. Step 2: how to account for warranties provided?

[IFRS 15.B28-B33]

The accounting treatment of a warranty provided in connection with the sale of a product depends on the nature of the warranty:

- if the customer is obliged to purchase the warranty and it only provides the assurance that the product will function as the parties intended because it complies with agreed-upon specifications (e.g. a warranty required by law), a provision shall be recognised for the cost of settling the obligation (in accordance with IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*);
- if the warranty is optional or provides a distinct service in addition to the assurance above, it constitutes a separate performance obligation to which a portion of revenue shall be allocated and recognised over the period of service provision.

If the customer does not have the option of purchasing the warranty separately, it can sometimes be difficult to determine whether it is an assurance-type warranty or a service-type warranty. When assessing this, IFRS 15 requires the entity to consider factors such as:

- **the legal obligation to provide the warranty:** if the entity is required by law to provide a warranty, the existence of that law indicates that the promised warranty is not a performance obligation, because such requirements typically exist to protect customers from the risk of purchasing defective products;
- **the duration of the warranty:** the longer the coverage period, the more likely it is that the promised warranty is a performance obligation, because it is more likely to provide a service to the customer in addition to the assurance that the product complies with agreed-upon specifications;
- **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 the 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.

If the warranty provides both assurance and a service and it is not reasonably possible to account for them separately, the entity shall recognise them together as a single performance obligation.

The Standard also states that a law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a separate performance obligation.



Some contracts include clauses that guarantee the performance of a good or service transferred to the customer. If the entity does not meet the performance objectives specified in the contract, or if it over-performs, the revenue from the contract may vary due to payment of penalties or receipt of a bonus. This type of guarantee is not covered by the provisions described above and shall be accounted for in step 3 of the model (determining the transaction price and estimating variable consideration; cf. **questions 28 and 29**).

24. Step 2: how to account for non-refundable upfront fees paid by customers?

[IFRS 15.B48-B51]

At contract inception, the entity may charge the customer a non-refundable upfront fee (e.g. entry fees or joining fees, activation fees, etc.).

Although these payments may relate to potentially substantial costs incurred by the entity at contract inception, the entity must carry out an analysis to determine whether:

- the activities carried out by the entity transfer a good or service to the customer (cf. **question 16**): in this case, the entity shall assess whether this good or service is distinct from the other goods or services promised in the contract (cf. **question 18**); or
- the non-refundable upfront fee is an advance payment for a good or service to be transferred to the customer at a future date.

In the latter case, the non-refundable payment received from the customer shall be recognised in the balance sheet as a contract liability (cf. **question 83**) until the related goods or services are transferred to the customer. The revenue recognition period may extend beyond the initial contract term if the entity grants the customer the option to renew the contract, and this option provides a material right to the customer (cf. **question 71**). This is the case when an entity charges a non-refundable upfront fee that the customer does not need to pay again on contract renewal (e.g. joining fees of 100 to use a sports club for 12 months, which the customer does not need to pay again if they decide to extend the contract by automatic renewal). In practice, this means that revenue is recognised over a period that includes the original fixed-term contract but also any periods covered by renewal options that the customer is likely to exercise.

25. Step 2: how to determine whether a licence is distinct from other contract promises, and what are the accounting impacts?

[IFRS 15.B52-B56]

The promises in the contract may include the grant of a licence that establishes the customer's rights to the entity's intellectual property (e.g. software, trademarks etc.).

As with any promise, the first step is to determine whether it is distinct from other promises in the contract (cf. **question 18**).

IFRS 15 gives some examples of licences that are not distinct from other promised goods or services in the contract:

- a licence that forms a component of a tangible good and that is integral to the functionality of the good;
- a licence that the customer can benefit from only in conjunction with a related service (such as an online service provided by the entity that requires the customer to have a licence in order to access content).



If the promise to grant a licence is not distinct from other promised goods or services in the contract, the entity shall account for the promise to grant a licence and those other promised goods or services together as a single performance obligation. Besides, an entity shall apply the general principles set out in IFRS 15 to determine whether revenue from the performance obligation that includes the licence shall be recognised over time or at a point in time (cf. **questions 52 and 61**).



If the licence is not a separate performance obligation but is the primary component of the combined good or service that includes the licence, the Basis for Conclusions states that the entity shall take into account the nature of the licence (i.e. the “right to access” or “right to use” the entity’s intellectual property) when assessing the pattern of transfer of control (cf. IFRS 15.BC404).

Thus, in practice, judgement may be required to determine when the specific provisions relating to licences shall be applied. In all cases, the resultant accounting treatment must be consistent with the general principles of the Standard.

If the promise to grant the licence is a separate performance obligation, the entity must assess the nature of the promise to the customer in order to determine whether it provides a “right to access” the entity’s intellectual property (cf. **question 75**) or a “right to use” it (cf. **question 76**). This stage in the analysis, which is specific to licences, helps the entity to determine whether control of the licence is transferred to the customer over time or at a point in time. The Standard specifies the criteria used to make this distinction (cf. **question 77**).





STEP 3: DETERMINATION OF THE TRANSACTION PRICE

[QUESTIONS 26 TO 40]



26. Step 3: what is the transaction price?

[IFRS 15.46-47 & IFRS 15.49]

The transaction price is defined in IFRS 15 as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

Thus, the transaction price is the amount of revenue ultimately recognised in relation to a contract (including one or more performance obligations) as identified in step 1 of the model (cf. **question 9**). This amount *de facto* excludes optional amounts until such time as the options are exercised, as these amounts do not result from the parties' enforceable rights and obligations.

It also excludes amounts collected on behalf of third parties (e.g. taxes collected on behalf of the State). It should be noted that, unlike Topic 606, IFRS 15 does not provide an accounting policy election that permits an entity to exclude from the measurement of the transaction price all taxes imposed by a State or similar authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected from customers. Thus, this must be assessed on a case-by-case basis.

When determining the transaction price, an entity shall take into account the contract terms and its customary business practices. It shall also 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.

27. Step 3: what items should be taken into account when determining the transaction price?

[IFRS 15.48 & IFRS 15.51-52]

The transaction price shall take account of the following:

- **variable consideration** (cf. **questions 28** and **30**), bearing in mind that IFRS 15 places a constraint on estimates of variable consideration (cf. **question 29**). Variable consideration includes any item that may lead to variation in the transaction price and that thus introduces an element of uncertainty as to the amount to which the entity will be entitled. Such items include discounts, rebates, penalties, performance bonuses, price revision clauses, customer's right of return (cf. **question 31**), etc. They may be explicitly stated in the contract or they may arise from an entity's customary business practices, published policies or specific statements that lead the customer to expect that the entity will accept an amount of consideration that is less than the price stated in the contract;
- **the existence of a significant financing component in the contract** (cf. **questions 32** to **38**): at contract inception, the entity must consider whether the transaction price should be adjusted to take account of the time value of money. The timing of payments agreed by the parties (either explicitly or implicitly) may provide a significant financing benefit to either the entity (in the case of upfront payment) or the customer (in the case of payment in arrears). Thus, revenue recognised may need to be adjusted for the effect of payment timing so that the amount (better) reflects the cash selling price for the goods or services;
- **non-cash consideration** (cf. **question 39**), e.g. a share-based payment;
- **consideration payable to a customer** (cf. **question 40**).





It is not always easy to identify when an amount of variable consideration is present.

Even when the price stated in the contract is fixed, the contract may include one or more items of variable consideration (e.g. a price reduction of up to x% of the stated price in the contract if a liquidated damages clause is upheld).

Finally, an entity must distinguish between:

- customer credit risk (cf. **question 11**) and a price concession implicitly offered to the customer;
- a warranty (cf. **question 23**) and a bonus or penalty linked to the performance of the asset (e.g. the number of failures over a given period for a product for which the entity provides preventive maintenance services);
- an option (cf. **question 71**), whatever the likelihood that it will be exercised, and variable consideration dependent on the volumes actually consumed by the customer (e.g. the number of work units consumed over a given period under an outsourcing services contract, when the price per unit is fixed; the variability thus depends on the extent to which the customer makes use of the service).

28. Step 3: how should variable consideration be estimated?

[IFRS 15.50 & IFRS 15.53-54]

When the transaction price includes a variable amount, the entity shall estimate the amount of consideration to which it will be entitled in exchange for transferring the promised goods or services to the customer. This step is particularly difficult if the uncertainty that causes the variability is not resolved until after the point at which the related revenue must be recognised (based on transfer of control to the customer of the good or service underlying the performance obligation). In other words, if the uncertainty has already been resolved when the revenue is recognised, the entity does not need to estimate the amount, but will simply recognise the amount of consideration that it knows it is receiving.

When an estimate is necessary, the entity shall use one of the two following methods to estimate the amount of revenue to which it expects to be entitled:

- **the “expected value” method** (the sum of the range of possible consideration amounts, weighted by probability): this method may be appropriate if the entity has a large number of contracts with similar characteristics. It should be noted that this method could result in a transaction price for an individual contract that the entity could never actually receive from that contract (as it is an average value that may have been calculated using a portfolio of data relating to several contracts with similar characteristics). However, this does not mean that the method cannot be used (as confirmed by the TRG when it examined this topic);
- **the “most likely amount” method** (i.e. the amount that is the most likely in a range of possible consideration amounts): this method may be appropriate if the contract has only two possible outcomes (for example, the entity may or may not obtain a bonus for delivering the product ahead of schedule). In practice, it may also be appropriate if probabilities appear to cluster around one particular scenario.



Example 4

An entity enters into a contract with a customer to construct a building. The entity is entitled to a fixed consideration of €2.5m and a performance bonus of an amount between €0 and €500k.

The entity has the following information available to it for estimating the performance bonus:

Probability of obtaining the bonus	Estimate of the variable amount
10%	0
30%	€100k
40%	€300k
20%	€500k

Using the “expected value” method, the entity would estimate the performance bonus at €250k:

$$10\% \times 0 + 30\% \times 100 + 40\% \times 300 + 20\% \times 500 = €250k$$

Conversely, using the ‘most likely amount’ method, the entity would estimate the performance bonus at €300k: the scenario in which the entity receives €300k is the most likely of all the possible scenarios.

Once the entity has estimated the variable consideration, it must apply the provisions of IFRS 15 on constraining variable consideration (cf. **question 29**). However, in practice, the two steps may blend into one another if the entity takes account of the constraints when it is estimating variable consideration, given that in both cases, as shown above and below, the analysis is largely qualitative.

The decision on which method to use is not a “free choice” or an accounting policy election. For each contract assessed (or for each type of variable consideration within a contract, if the contract includes several), the entity shall use the method that better predicts the amount of variable consideration to which it will be entitled. The chosen method shall be applied consistently throughout the contract term.

Furthermore, the entity must take account of all the information (historical, current and forecast) that is reasonably available, and shall identify a reasonable number of possible consideration amounts. To do this, the entity may use information similar to that used by management during the bid-and-proposal process and in establishing prices for goods or services.

The Basis for Conclusions (cf. IFRS 15.BC201) explains that IFRS 15 does not necessarily require an in-depth quantitative analysis. Specifically, an entity does not need to consider every single possible outcome when using the “expected value” method. Similarly, when using the “most likely amount” method, an entity does not need to quantify the less probable outcomes. The IASB notes that in many cases it is not necessary to use complex (and hence costly) models and techniques.



29. Step 3: how shall the principles for constraining estimates of variable consideration be applied?

[IFRS 15.56-57]

Once the entity has estimated the amount of variable consideration (cf. **question 28**), it must include all or part of this amount in the transaction price. IFRS 15 includes a mechanism for ensuring that an entity has been sufficiently prudent when recognising revenue to date. The objective of this mechanism is to ensure that revenue is neither overestimated nor recognised prematurely.

Thus, the entity shall recognise an amount of variable consideration only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised to date will not occur (i.e. when the uncertainty associated with the variable consideration is subsequently resolved). In practice, when assessing the extent of the constraint on the amount of variable consideration to be recognised, the entity shall consider both the likelihood (a high level of confidence is required) and the magnitude of a possible revenue reversal.

IFRS 15 lists a number of factors that could increase the likelihood or magnitude of a revenue reversal:

- the amount of consideration is highly susceptible to factors outside the entity's influence, such as volatility in a market, the judgement or actions of third parties, weather conditions, a high risk of obsolescence of the promised good or service;
- the uncertainty about the amount of consideration is not expected to be resolved for a long period of time;
- the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value;
- the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances;
- the contract has a large number and broad range of possible consideration amounts.

The IFRS 15 Basis for Conclusions states that the magnitude of a potential revenue reversal shall be assessed relative to the total transaction price (cf. IFRS 15.BC217), including any fixed consideration. In practice, this means that if the estimate of variable consideration is not significant relative to the total transaction price, the application of the constraint will not affect the amount of revenue recognised for the variable consideration.

The TRG (cf. **question 98**) stated following its January 2015 meeting that the magnitude of a potential revenue reversal should be assessed at the contract level, rather than at the level of the performance obligation to which the variable consideration relates.

Finally, it should be noted that application of the constraint does not necessarily require an entity to carry out a complex and costly quantitative analysis. The Basis for Conclusions notes that the required analysis would be largely qualitative (cf. IFRS 15.BC212).



Example 5

Following on from example 4 (cf. **question 28**): applying the constraint on estimates of variable consideration, the entity estimates that it has a 90% probability of obtaining a performance bonus of at least €100k. This is the amount that the entity uses when determining the transaction price.



Where variable consideration takes the form of a sales-based or usage-based royalty payable by the customer in exchange for a licence of intellectual property, this consideration is not accounted for in accordance with the general principles set out above. Instead, it is covered by specific provisions (cf. **question 78**).

30. Step 3: how frequently should estimates of variable consideration be reassessed?

[IFRS 15.59]

Variable consideration shall be estimated at contract inception and re-estimated at the end of each reporting period to take account of any changes in circumstances. The entity shall also re-assess whether the estimate of variable consideration is constrained.

Any change in variable consideration shall be allocated to one or more performance obligations on the same basis as at contract inception (cf. **question 48**). The resultant change in the transaction price shall be immediately recognised as revenue if the variable consideration is allocated to a performance obligation that has already been satisfied at the date when the estimate is updated (cf. **question 49**).

31. Step 3: how should a sale with a right of return be accounted for?

[IFRS 15.55 & IFRS 15.B20-B27]

A sale with a right of return is a sale in which an entity transfers control of a product to the customer and also grants the customer the right to return the product for various reasons and receive one or more of the following:

- a full or partial refund of any consideration paid;
- a credit note that can be applied against amounts owed or that will be owed to the entity;
- another product in exchange.

These principles do not apply to the following situations:

- a customer exchanges one product for another of the same type, quality, condition and price (for example, one colour or size for another);
- the contract stipulates that the customer may return a defective product in exchange for a functioning product: this situation shall be evaluated in accordance with the guidance on warranties (cf. **question 23**).

In practice, a sale with a right of return is similar to a sale where the customer has a right of withdrawal (e.g. in the case of online clothes purchases).



IFRS 15 stipulates that an entity shall recognise all of the following to account for a sale with a right of return:

- revenue for the transferred products in the amount of consideration to which the entity expects to be entitled. Therefore, revenue would not be recognised for the products expected to be returned;
- a liability for future refunds (to take account of expected returns and thus amounts of consideration to which the entity does not expect to be entitled);
- an asset (and a corresponding adjustment to cost of sales) for the entity's right to recover products from customers on settling the refund liability. This asset shall initially be measured by reference to the carrying amount of the product (for example, inventory) less any expected costs to recover those products (including potential decreases in the value to the entity of returned products).

The rules on estimating variable consideration (cf. **question 28**) and on constraining estimates of variable consideration (cf. **question 29**) thus apply when determining the amount of revenue to be recognised for a sale with a right of return. In practice, an entity will often make this estimate by determining the expected value based on a number of contracts with similar characteristics. The estimate will thus differ from the figure that the entity would have obtained by assessing the most likely outcome of a single transaction. However, this does not mean that the expected value method cannot be used.

The entity shall update its estimate of expected returns at the end of each reporting period. Any change in the transaction price and any adjustment to the refund liability shall be recognised immediately as an adjustment to revenue.

Example 6

An entity enters into 200 contracts with customers, each of which comprises the sale of one product for €80. The entity's customary business practices permit customers to return an unused product (for whatever reason) within 15 days and to receive a full refund. The entity's cost of each product is €50.

As a result of the customers' right of return, the 200 contracts include variable consideration.

The entity uses information on the 200 similar contracts to estimate the variable consideration using the expected value method.

Using the expected value method, the entity estimates that 170 products will not be returned. The entity also concludes that it is highly probable that a significant revenue reversal relating to these 170 products will not occur during the return period.

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

The table below shows the entity's balance sheet entries:

Balance sheet (in €)			
Inventory (including the right to recover 30 of the 200 products transferred): 30*50 - (200*50))	(8,500)	Profit or loss (revenue of 170*80 = 13,600 minus cost of sales of 170*50 = 8,500)	5,100
Receivable (200*80)	16,000	Liability for future refunds (30*80)	2,400
Total assets	7,500	Total liabilities	7,500

If the entity has no reliable data on returns, the application of the constraints means that the entity must wait until the 15-day return period has expired before it can recognise revenue for the sale.

32. Step 3: how to identify a significant financing component in a contract?

[IFRS 15.60-61]

As a reminder (cf. **question 27**), the transaction price shall be adjusted where necessary to take account of the time value of money if the timing of payments agreed by the parties (either explicitly or implicitly) provides either the customer (in the case of payment in arrears) or the entity (in the case of upfront payment) with a significant benefit of financing the transfer of goods or services to the customer.

IFRS 15 states that all facts and circumstances must be taken into account when assessing whether a contract contains a significant financing component. In particular, an entity shall consider the following:

- the difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services;
- the combined effect of both of the following:
 - > the expected length of time between when the entity recognises revenue (i.e. when it transfers control of the promised goods or services to the customer) and when the customer pays for those goods or services; and
 - > the prevailing interest rates in the relevant market (cf. **question 35**).

Determining whether a contract contains a significant financing component thus requires an entity to make use of judgement.

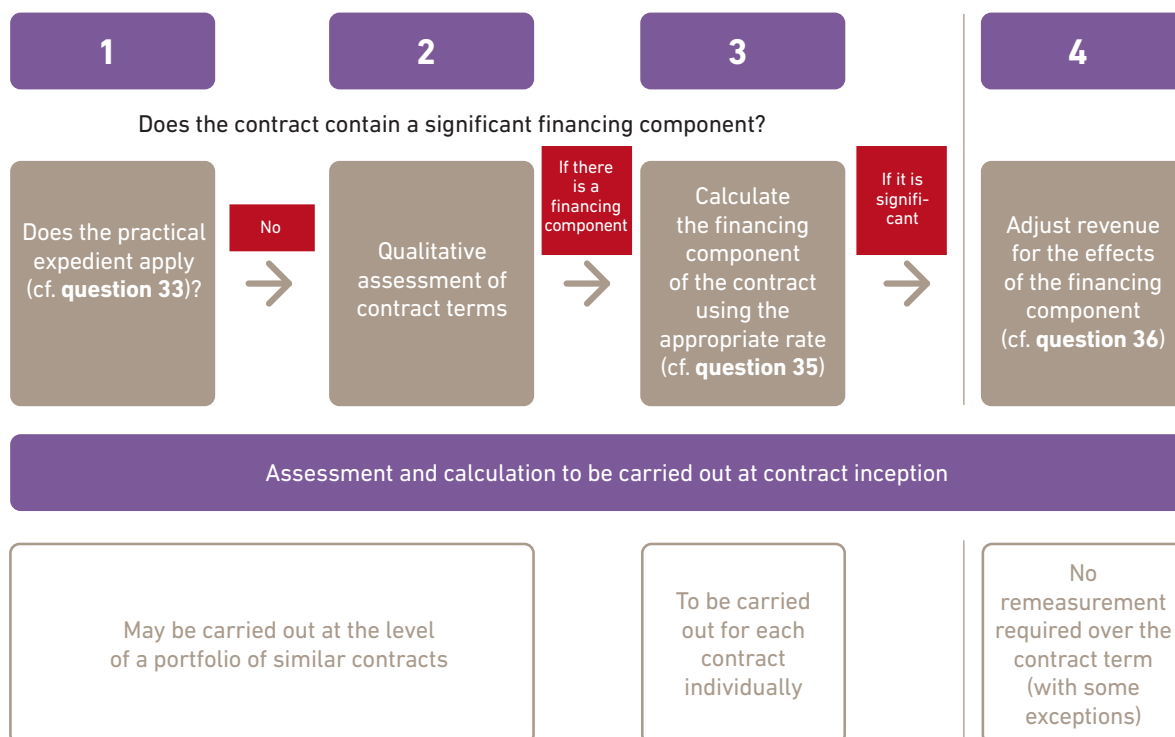
The assessment of whether the financing component is “significant” shall be carried out at the level of the individual contract, rather than at the portfolio level. Thus, if a financing component is not significant at the contract level, but the combined effects for a portfolio of similar contracts are material to the entity as a whole, IFRS 15 does not require the entity to adjust the contracts in the portfolio, as the complexity of the calculations would be unduly burdensome (IFRS 15.BC234).

In a low interest rate environment, a long delay between revenue recognition and payment is less likely to result in the identification of a significant financing component (and thus an adjustment to revenue). Therefore, this time delay is not the only factor to be taken into account. However, IFRS 15 does not prohibit an entity from making an adjustment to revenue if it identifies a financing component that is not significant.

Moreover, IFRS 15 includes a practical expedient for contracts for which the entity expects that the period between the transfer of a promised good or service to a customer, and the payment for that good or service, will be one year or less (cf. **question 33**).

Finally, an entity shall assess whether a contract contains a significant financing component at contract inception and is not required to review this subsequently, even if the customer payment (or the entity's right to recognise revenue) is delayed from what was originally expected. However, an entity may need to re-assess in the event of a contract modification.

Figure 7: determining whether a contract contains a significant financing component



33. Step 3: what practical expedient does IFRS 15 offer when accounting for the effects of a financing component?

[IFRS 15.63]

As a practical expedient, IFRS 15 states that an entity need not adjust the transaction price of the contract for the effects of any significant financing component if the entity expects, at contract inception, that the period between when the entity recognises revenue for the transfer of a promised good or service and when it receives payment from the customer will never exceed one year.

It should be noted that this practical expedient can *de facto* be applied to contracts with an initial term of one year or less. It may also be applicable to much longer contracts; however, if revenue is recognised over time, it may in practice be difficult to predict at contract inception whether the period between revenue recognition and milestone payments will ever exceed one year over the entire term of the contract.

The practical expedient may continue to be applied if payments are delayed compared with the timing that was expected initially (and that was justified the use of the practical expedient).

Like all practical expedients permitted under IFRS 15, it shall be applied consistently to similar contracts in similar circumstances.



34. Step 3: in what situations does IFRS 15 specify that a contract does not include a financing component?

[IFRS 15.62]

In some cases, although there is a significant time delay between the transfer of goods or services to the customer and the payment, this is not related to a financing arrangement (cf. **question 32**).

Thus, a contract does not contain a significant financing component as defined in IFRS 15 if one of the following three factors exists:

- the customer paid for the goods or services in advance and the timing of the transfer of those goods or services is at the discretion of the customer (e.g. mobile phone top-up cards);
- a substantial amount of the consideration promised by the customer is variable and the amount or timing of that consideration depends on the occurrence or non-occurrence of a future event that is not substantially within the control of the customer or the entity (e.g. a sales-based royalty);
- the difference between the promised consideration and the cash selling price arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to (i.e. consistent with) the reason for the difference (e.g. the customer retains 5% of total payments throughout a construction contract to provide assurance that the entity will complete its obligations satisfactorily; this is only payable after a two-year period).

The third situation discussed above seems relatively broad in scope. In contrast, the Basis for Conclusions states that the Standard does not exempt an entity from identifying (where appropriate) a significant financing component representing the effects of advance payments (cf. IFRS 15.BC238). This applies even if the advance payments permit the entity to procure materials necessary to satisfactorily fulfil the contract or to pay sub-contractors in advance. The Basis for Conclusions also appears to suggest that an entity still needs to assess whether a significant financing component exists even if the advance payment is made to protect the entity against customer credit risk. In practice, an entity should not exclude contracts from the analysis when a customer makes advance payments, if the entity has clearly benefited from the effect of a significant financing component. The facts and circumstances shall be assessed on a case-by-case basis and the entity will need to use its judgement.

35. Step 3: what interest rate should be used to calculate the financing component in a contract?

[IFRS 15.64]

IFRS 15 states that 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 in order to determine whether a significant financing component exists and, if necessary, to adjust the revenue recognised (cf. **question 32**).

This rate reflects the credit characteristics of the party that benefits from the effect of a financing component, according to the entity's analysis of the contract. In other words, it reflects the customer's credit characteristics, if the entity has offered the customer favourable payment terms. Conversely, it reflects the entity's credit characteristics, if the customer is paying in advance.

It also takes account of any collateral or security provided by the customer (or the entity), including assets transferred in the contract.

The entity may be able to determine this rate by identifying the rate that discounts the nominal amount of the promised consideration to the price that the customer would pay in cash for the goods or services when (or as) they transfer to the customer. However, the rate implicit in the contract does not necessarily reflect the discount rate that would be used by the parties in a separate financing transaction (in which case it would not be appropriate to use the implicit rate to calculate the financing component).

The discount rate used to identify and calculate any significant financing component is determined at contract inception and is not subsequently updated, irrespective of whether interest rates change subsequently or other changes in circumstances occur (e.g. a change in the assessment of customer credit risk).

36. Step 3: how should the effects of significant financing be recognised and presented?

[IFRS 15.65]

If the application of IFRS 15 has led the entity to identify a significant financing component (cf. **question 32**), the transaction price shall be adjusted to take account of the time value of money.

If payments are received after the good or service is transferred, the entity is financing the customer and revenue is adjusted such that the amount recognised is lower than the payment received. The difference is recognised as interest revenue (financial remuneration from the customer for the financing provided).

If payments are received before the good or service is transferred, the customer is financing the entity and revenue is adjusted such that the amount recognised is higher than the payment received. The difference is recognised as interest expense (the cost of the financing provided by the customer to the entity).

Thus, revenue is only recognised to the extent of the cash selling price. Interest revenue or expense resulting from the identification of a significant financing component reflects the effects calculated in accordance with the principles set out above, for the purposes of revenue presentation: it is not the same as investment income or financing costs, which are generated by the net cash position of the contract.

IFRS 15 stipulates that the effects of financing (interest revenue or expense) shall be presented separately from revenue in the statement of comprehensive income, but does not specify the heading under which this revenue or expense should be presented. We believe it will generally be most appropriate to present it within the financial result.

This interest revenue or expense is recognised only to the extent that a contract asset (or a receivable – cf. **questions 82 and 84**) or a contract liability (cf. **question 83**) is recognised in accounting for a contract with a customer.



37. Step 3: how to apply the approach for identifying a significant financing component to a contract that includes several performance obligations?

The transaction price, which takes account of any financing effects, is determined at the contract level. Thus, the entity only needs to adjust the transaction price if the financing component is significant at the level of the contract in question.

Having said that, the process used to determine whether any significant financing component exists (cf. **question 32**) assumes that the entity is in a position to determine the length of the period between when the entity recognises revenue and when it receives payment for the goods or services transferred. This can only be determined at the level of each individual performance obligation in the contract (cf. **question 16**), i.e. after having determined the transaction price of the contract – and thus having taken account of any significant financing component (cf. **question 27**) and allocated it to each performance obligation (cf. **question 42**).

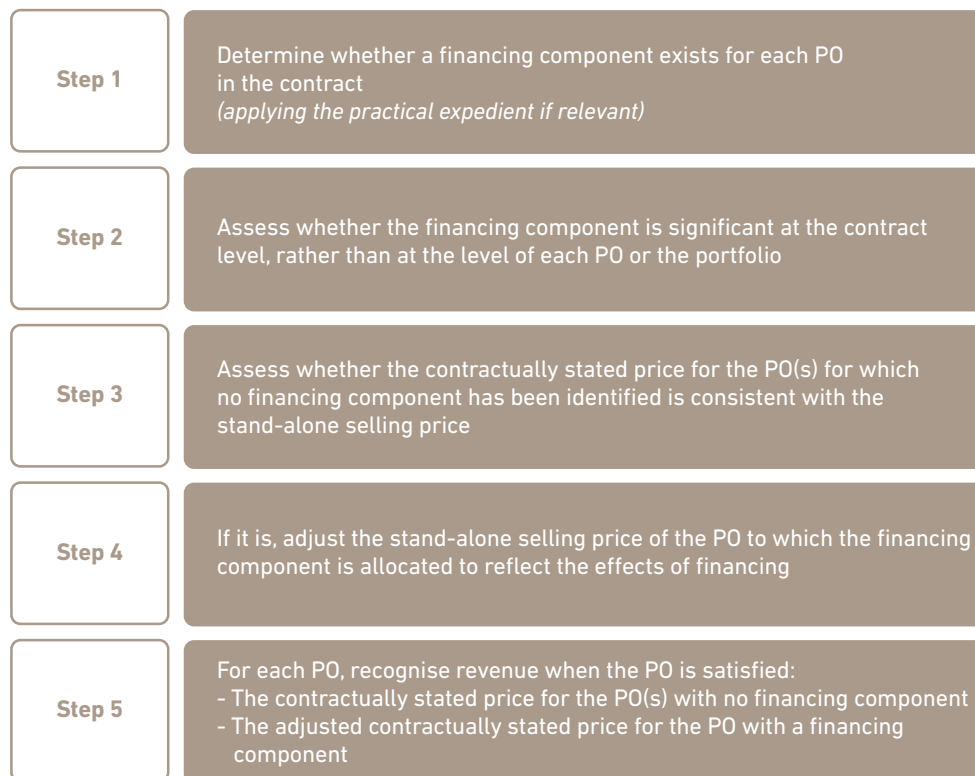
Since IFRS 15 does not provide any clarification on how to resolve this circular problem, we present below an approach that we believe is reasonable. As suggested by the TRG (cf. **question 98**) following its March 2015 meeting, our approach is analogous to the provisions in the Standard for allocating the transaction price to performance obligations when a portion of the consideration is variable.

Figure 8: proposed approach when it is difficult to determine which performance obligation the financing component relates to

Step 1	Allocate the estimated transaction price for the contract to each PO <u>first of all</u> (i.e. before taking account of the effects of any financing component in the contract)
Step 2	Determine whether a financing component exists at the level of each PO in the contract (applying the practical expedient if relevant)
Step 3	Assess whether the financing component is significant at the contract level, rather than at the level of each PO or the portfolio
Step 4	Adjust the transaction price if a significant financing component exists
Step 5	Allocate the adjustment to revenue to each PO based on the relative stand-alone selling price of each PO
Step 6	- For each PO, recognise the adjusted revenue when (or as) the PO is satisfied - Recognise interest revenue or expense



Figure 9: proposed approach when it is easy to determine which performance obligation the financing component relates to



38. Step 3: in practice, how is a significant financing component in a long-term contract identified?

The approach used to determine whether a significant financing component exists (cf. **question 32**) is applicable to all types of contract, including long-term contracts.

However, applying the approach to long-term contracts may give rise to particular implementation challenges, particularly when assessing whether the practical expedient permitted by IFRS 15 (cf. **question 33**) can be applied to performance obligations satisfied over time.

Furthermore, it should be noted that IFRS 15 requires an entity to determine whether any significant financing component exists based on the difference between revenue recognised and consideration received from the customer; this may differ from practices used by entities in the past. Thus the difference between payments made by the entity to fulfil the contract (procurement of raw materials, payments to sub-contractors, etc.) and the consideration received from the customer (i.e. the net cash position of the contract) should not be taken into account under IFRS 15 (cf. **question 34**).



For a long-term contract, the financing component may be calculated as follows:

- the entity identifies the average under/over-financing for the contract for a given period, using the relevant discount rate (cf. **question 35**), so as to determine the financing component for the period;
- the total financing component for the contract is the sum of all the components identified for the various periods.

Figure 10



39. Step 3: how should non-cash consideration be measured?

[IFRS 15.66-69]

IFRS 15 requires that consideration in a form other than cash shall be measured at fair value. If an entity cannot reasonably estimate this fair value, it shall measure the consideration by reference to the stand-alone selling price (cf. **question 43**) of the goods or services promised to the customer in exchange for the consideration.

The fair value of the non-cash consideration may vary because of the form of the consideration (for example, the price of a share that an entity is entitled to receive from a customer may fluctuate). If the fair value of the non-cash consideration varies for reasons other than only the form of the consideration, an entity shall apply the provisions of the Standard on constraining estimates of variable consideration (cf. **question 29**).

In some cases, the entity will need to determine whether it has obtained control of goods or services provided by the customer (i.e. contributed for free) to facilitate the entity's fulfilment of the contract (e.g. raw materials, equipment or labour). If control is transferred, these goods or services form part of the transaction price and shall be accounted for in line with the provisions set out above.

Finally, it should be noted that the Standard does not stipulate the date at which non-cash consideration should be measured. This has been discussed by the TRG (cf. **question 98**) but, unlike the FASB, the IASB decided not to amend IFRS 15 to clarify this point. In the absence of any guidance from the Standard, any of the following dates would seem to be acceptable in practice:

- at contract inception (as required under Topic 606);
- when the non-cash consideration is received from the customer; or
- at whichever is the earlier of the date when the non-cash consideration is received from the customer and the date when the performance obligation is fulfilled.

An entity thus has a choice of accounting principle, but the date selected must be applied consistently to all non-cash consideration received from customers. If non-cash consideration is significant, the entity shall disclose its choice of accounting principle in the notes (cf. **question 86**).

40. Step 3: in what circumstances should consideration payable to a customer be accounted for as a reduction in the transaction price?

[IFRS 15.70-72]

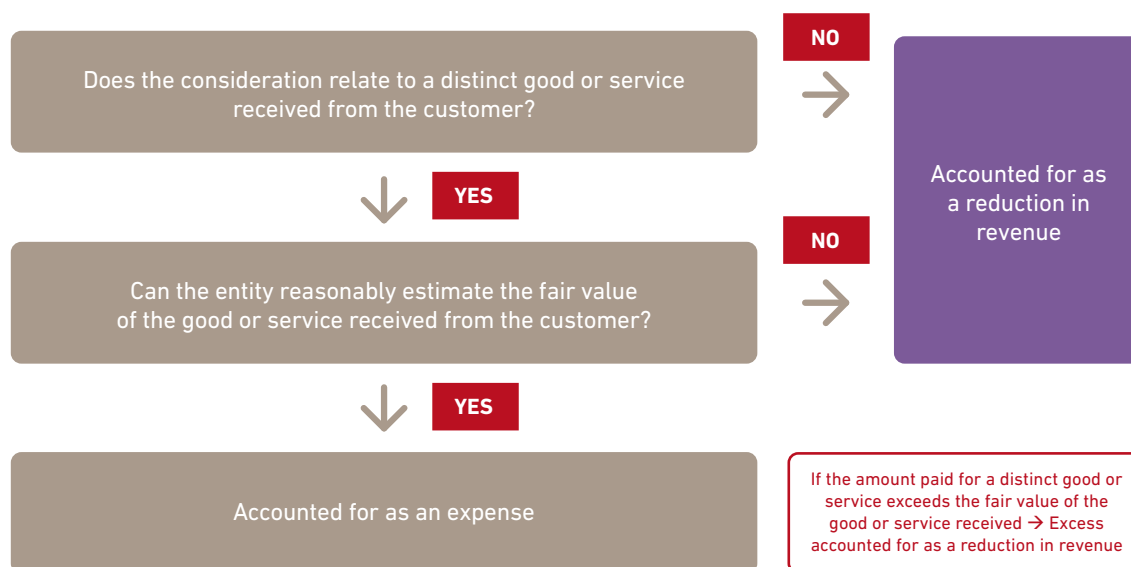
An entity may pay, or expect to pay, consideration to a customer. Consideration payable to a direct customer (such as a distributor) or an indirect customer (such as a consumer who purchases the entity's goods or services from an intermediary) may take several forms (coupons, volume rebates, slotting fees, etc.). It thus includes any payments in a product's distribution chain, whether these are payments to companies or individuals.

This issue most often arises in the consumer goods sector, where it is difficult to distinguish between a trade discount (accounted for as a reduction in revenue) and genuine distribution/marketing costs (accounted for as expenses). However, industrial companies (e.g. in the aeronautical sector) may also make payments to a customer at contract inception, offering a "trade concession" in order to win a contract with a customer.

IFRS 15 stipulates that consideration payable to a customer shall be accounted for as a reduction in revenue, unless the payment to the customer is in exchange for a distinct good or service received from the customer (in which case the customer is also a supplier) and the entity can reasonably estimate the fair value of this good or service. If both these conditions are fulfilled, the consideration is accounted for as a normal purchase from a supplier. If the amount of consideration payable to the customer for the purchase of a distinct good or service exceeds the fair value of the good or service received from the customer, the excess is accounted for as a reduction in revenue. If the entity cannot reasonably estimate the fair value of the good or service, it shall account for all of the consideration payable to the customer as a reduction in revenue.



Figure 11



It should be noted that these provisions are based heavily on those that existed previously under the US accounting framework. Thus, when assessing whether a good or service is “distinct”, the entity should use the former US GAAP concept of “identified benefit”, which was 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. In other words, an entity must assess whether it would be able to obtain an identical good or service from another party, independently of the sale of its own goods and services. Judgement may be required to distinguish between consideration that is inseparable from the sale to the customer, and consideration for a distinct good or service received from the customer.

If consideration payable to a customer is accounted for as a reduction in revenue, an entity shall recognise the reduction when (or as) the later of either of the following events occurs:

- the entity recognises revenue for the transfer of the related goods or services to the customer;
- 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.



An entity may:

- make a payment to a customer (or a potential customer) even if a contract as defined in IFRS 15 does not exist at the time of payment (cf. **question 9**) – in this case, the entity may make the payment in anticipation of future purchases by this customer; or
- make a payment to a customer where a contract as defined in IFRS 15 exists, but the payment relates to both the current contract and future contracts that the entity expects to enter into with the customer.

In these situations, a question arises as to whether the payment may be capitalised, and then amortised over time as a reduction in revenue as the related goods and services are transferred to the customer, taking account of contracts that do not yet exist as defined in the Standard. If this is not permissible, the payments would be recognised as a reduction in revenue from the existing contract; if no contract as defined in IFRS 15 exists, the payments would be immediately recognised in revenue (i.e. “negative” revenue would be recognised).

At its November 2016 meeting, the TRG (cf. **question 98**) concluded that either approach could be appropriate depending on the situation, and it would thus be necessary to analyse all the facts and circumstances in order to determine the correct accounting method (notably, the entity should understand the reasons for the payment, the rights and obligations resulting from the payment (if any), and the nature of the promise(s) in the contract (if any)). Thus, this is not an accounting policy election. The TRG noted that recognising the consideration as an asset (usually a contract asset) at or before contract inception, and subsequently amortising it as a reduction in revenue as the goods and services are transferred to the customer under the existing contract (if one exists) and any expected future contracts, presupposes that the consideration meets the definition of an asset at the time of recognition.

These situations usually require significant judgement, firstly to determine whether an asset shall be recognised, and secondly to determine the period over which any such asset shall be amortised.



STEP 4:

ALLOCATION OF THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS

[QUESTIONS 41 TO 49]



41. Step 4: what is the objective when allocating the transaction price to the performance obligations in the contract?

[\[IFRS 15.73 & IFRS 15.75\]](#)

The objective when allocating the transaction price is to reflect the amount of consideration to which the entity expects to be entitled in exchange for transferring each of the promised goods or services to the customer.

In situations when allocating the transaction price is not straightforward, for example if it is necessary to estimate stand-alone selling prices (cf. **question 45**) or if the contract includes variable consideration (cf. **question 48**), an entity shall keep this objective in mind in order to ensure that the allocation complies with the general principles of IFRS 15.

In practice, step 4 does not present any challenges if there is only one performance obligation (cf. **question 16**). In fact, this step can simply be ignored in such case.

However, if an entity has identified a series of distinct goods or services that constitute a single performance obligation (cf. **question 21**), the entity shall apply the provisions of IFRS 15 on allocation of variable consideration (cf. **question 48**).

42. Step 4: what are the general principles for allocating the transaction price to the performance obligations in the contract?

[\[IFRS 15.74 & IFRS 15.76\]](#)

Usually, the transaction price shall be allocated to the performance obligations in the contract on a relative stand-alone selling price basis (cf. **question 43**). Specific rules apply if the customer receives a discount (cf. **question 47**) or if the contract includes variable consideration (cf. **question 48**).

The transaction price is allocated at contract inception and is not subsequently reviewed, even if the transaction price changes (cf. **question 49**).

The allocation of the transaction price to the various performance obligations identified in the contract (cf. **question 16**) may have significant impacts on revenue recognition if the allocation is very different from that used in the past (i.e. under previous Standards), which may have been the result of customary practices in a particular sector. In particular, in the telecoms sector, revenue recognised at the point of sale of a handset (as part of a bundle that also included a subscription) was historically limited to the consideration received from the customer for the handset. However, this payment does not usually reflect the stand-alone selling price of the handset, as telecom operators are often “subsidising” the customer’s purchase of the handset.

43. Step 4: what is the stand-alone selling price?

[\[IFRS 15.77\]](#)

The stand-alone selling price is the price at which an entity would sell a good or service to a customer separately from the other promises in the contract.

In some situations, the stand-alone selling price is directly observable (cf. **question 44**). In other situations, it must be estimated (cf. **question 45**).



44. Step 4: how should the stand-alone selling price for each performance obligation when this price is directly observable be determined?

[IFRS 15.77]

The stand-alone selling price for a performance obligation may be readily determined based on observable selling prices if the entity sells the underlying goods or services separately in similar circumstances and to similar customers.

The contractually stated prices for each good or service (or group of goods or services) that constitute a given performance obligation may be their stand-alone selling prices, but IFRS 15 specifies that an entity cannot presume that this is the case. However, in practice, if an entity sells specific goods or services to a given customer and the contract is *de facto* the only available price reference, an entity may frequently conclude (in the absence of any evidence to the contrary) that the contractually stated prices reflect the stand-alone selling prices and can thus be used for the purposes of revenue recognition. This is not possible, however, if the entity has information demonstrating that the contractually specified prices are not the stand-alone selling prices (e.g. because the customer asked for a price reduction on a particular good or service when negotiating the contract, which was then counter-balanced by a price increase on another good or service promised in the contract).

It should also be noted that a list price is not always an appropriate reference for determining the stand-alone selling price of a good or service (e.g. because the entity's customary business practices involve using list prices as a starting point for negotiations and ultimately offering customers a discount on a systematic basis).

If a stand-alone selling price is not directly observable, the entity shall estimate it (cf. **question 45**).

45. Step 4: how should the stand-alone selling price otherwise be estimated?

[IFRS 15.78-79]

If a selling price is not directly observable (cf. **question 44**), an entity shall estimate the stand-alone selling price of a good or service (or a group of goods or services), taking account of all information that is reasonably available (e.g. market conditions, entity-specific factors and information about the customer or class of customer). In practice, although IFRS 15 does not establish a hierarchy of evidence, an entity shall maximise the use of observable data.

The approaches used to estimate stand-alone selling prices shall be applied consistently in similar circumstances.

IFRS 15 gives some examples of suitable approaches:

- **adjusted market assessment approach:** the entity evaluates the market in which it sells the goods or services and estimates the price that a customer in that market would be willing to pay for those goods or services. This approach might also 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;
- **expected cost plus a margin approach:** the entity determines the expected cost of satisfying a performance obligation and then adds an appropriate margin for that good or service;
- **residual approach** (cf. **question 46**).

46. Step 4: in what circumstances may the residual approach be used?

[IFRS 15.79-80]

In contrast to previous texts (IAS 18 and IFRIC 13 – *Customer Loyalty Programmes*), IFRS 15 stipulates that an entity cannot use the residual approach whenever it wants to estimate the stand-alone selling prices of particular goods or services (cf. **question 45**).

In practice, this approach involves estimating the stand-alone selling price of a good or service at the difference between the total transaction price and the sum of the observable stand-alone selling prices of other goods or services promised in the contract.

Under IFRS 15, this approach may only be used if one of the following criteria is met:

- the selling price of the good or service is highly variable because the entity sells the same good or service to different customers (at or near the same time) for a broad range of amounts. In other words, a representative stand-alone selling price is not discernible from past transactions or other observable evidence;
- the selling price of the good or service is uncertain because the entity has not yet established a price for it, as it has not previously been sold on a stand-alone basis.

If a contract includes at least two goods or services with highly variable or uncertain selling prices, an entity may use the residual approach to estimate the aggregate stand-alone selling price for these goods or services, then use another method to allocate this aggregate to the individual goods or services with highly variable or uncertain selling prices.

Finally, if a discount is allocated to some, but not all, of the performance obligations in the contract (cf. **question 47**), the discount shall be allocated before the residual approach is applied.

47. Step 4: how should a discount offered to a customer be allocated?

[IFRS 15.81-83]

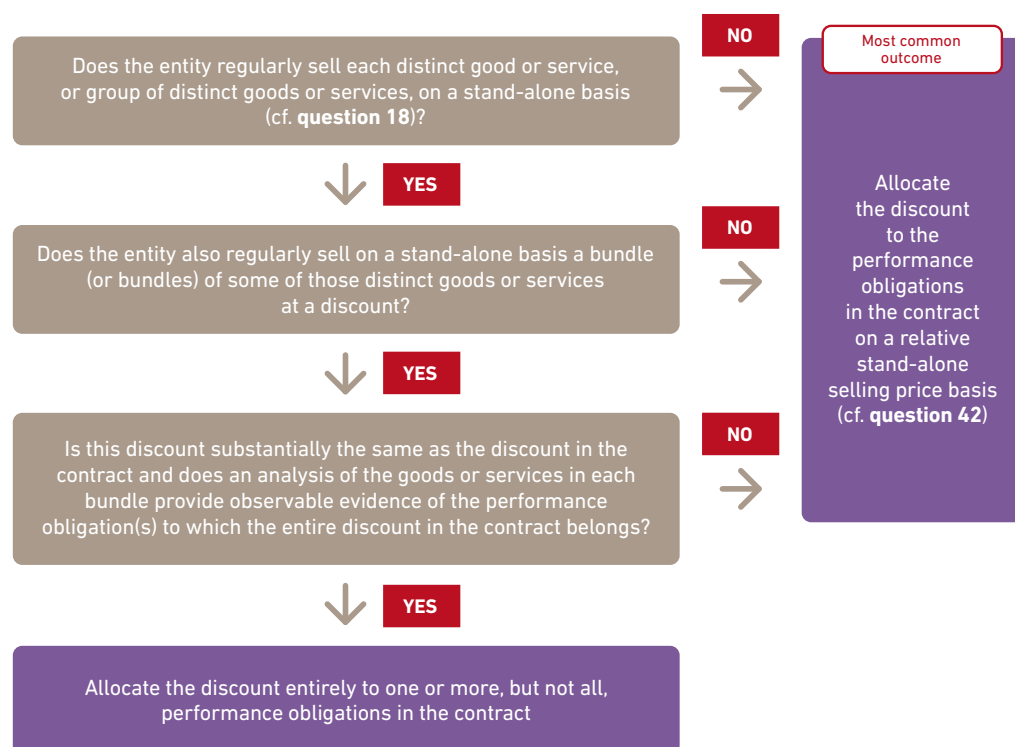
A customer receives a discount if the sum of the stand-alone selling prices (cf. **question 43**) of the promised goods or services in the contract exceeds the transaction price.

Bearing in mind the general principle that the transaction price shall be allocated to the performance obligations in the contract on a relative stand-alone selling price basis (cf. **question 42**), the default option is for the discount to be proportionately allocated to the performance obligations in the contract.

However, this does not always meet the objective of step 4 of the revenue recognition model (cf. **question 41**). Therefore, IFRS 15 includes specific provisions for identifying situations in which a discount shall be allocated to one or more, but not all, of the performance obligations in the contract.



Figure 12



A discount offered to a customer constitutes variable consideration if the amount of the discount depends on future events (e.g. a discount that depends on the amounts purchased by the customer). In this specific situation, the question may arise in practice as to which of the provisions in the Standard should be applied to allocate this discount to the performance obligations in the contract (as the Standard contains specific provisions for the allocation of both discounts and variable consideration to the performance obligations in the contract).

In March 2015, the TRG (cf. **question 98**) stated that the following approach should be used to determine whether the variable discount should be allocated to some performance obligations rather than others:

- first, apply the provisions on allocating variable consideration (cf. **question 48**);
- second, apply the provisions on allocating discounts (set out above).

If the discount is allocated entirely to one or more, but not all, performance obligations in the contract, the entity shall allocate the discount before the residual approach is applied in order to estimate the stand-alone selling price of a good or service (cf. **question 46**).

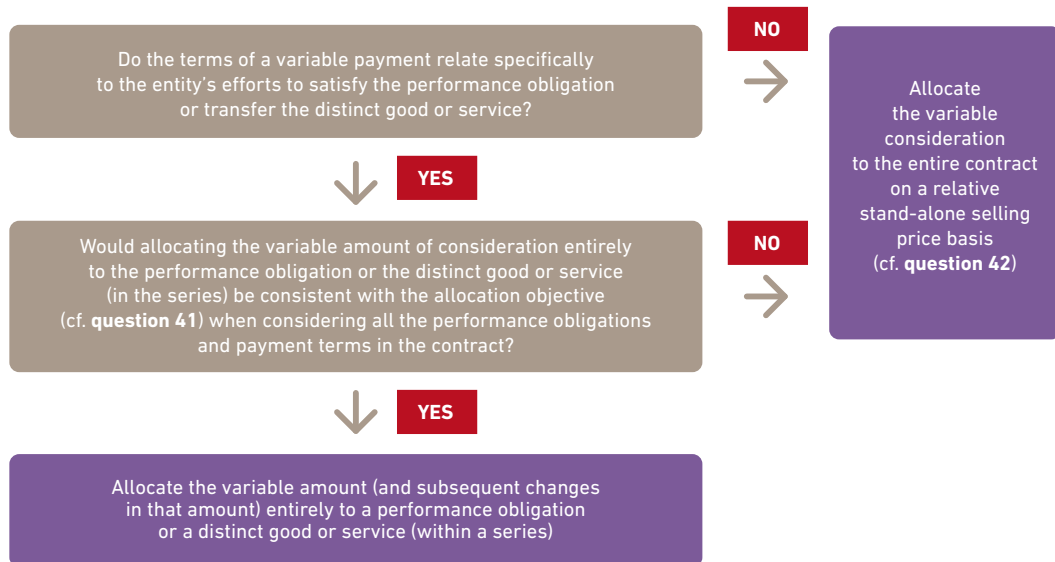


48. Step 4: how should variable consideration be allocated?

[IFRS 15.75 & IFRS 15.84-86]

IFRS 15 includes specific provisions on allocating variable consideration included in the transaction price. According to these provisions, if certain criteria are met, the variable consideration is not proportionately allocated to all the performance obligations in the contract (cf. **question 42**) but is instead allocated to one or more specific performance obligations.

Figure 13



If these criteria are met, the variable amount may need to be allocated to:

- one or more, but not all, of the performance obligations in the contract; or
- one or more, but not all, of the distinct goods or services in a series that constitutes a single performance obligation (cf. **question 21**).

Examples of such situations include the following:

- for the first situation detailed above, the payment of a bonus may be contingent on an entity transferring a promised good or service within a specified period of time;
- for the second situation detailed above, the consideration promised for the second year of a two-year cleaning service contract may increase on the basis of changes in a specified inflation index.

In practice, applying IFRS 15 in such situations may be complex and require the use of judgement.



Example 7

A digital services company enters into a “build and run” contract with a customer (an insurance company) to develop a claims processing platform over 12 months and then operate it for five years.

The platform is tailored to the customer and the contract also specifies that the entity shall provide the customer with all the documentation and support necessary for it to transfer the operation of the platform to another supplier at any time, if it so wishes. Moreover, there is no transformative relationship between the development of the platform and the operations services provided. Thus, the provision of the platform appears to be a separate performance obligation from the provision of the operations services.

The contract includes the following remuneration terms:

- > a one-off payment of €10m for the development of the platform;
- > late penalties if the entity does not meet the deadline specified in the contract for delivery of the platform, at a rate of 1/1,000th of the above one-off payment per day, up to a maximum of 10% of the one-off payment;
- > following delivery of the platform, an annual payment of €200k for ongoing operations services (updated each year in line with an index tracking salary changes in the IT sector).

The amounts detailed above are set from detailed quotes including a reasonable margin, and are deemed to be consistent with customary pricing practices in the sector for the same type of services provided separately.

The late penalties specified in the contract are specifically aimed at ensuring development of the platform is completed by a given deadline. Moreover, in the light of the customary pricing practices and methods used to arrive at contract prices in the sector, allocating the entirety of the one-off payment of €10m and the late penalties to the performance obligation representing the provision of the platform would seem to be consistent with the allocation objective of IFRS 15 (cf. **question 41**).

Consequently, at contract inception the entity concludes that the one-off payment of €10m and the variability resulting from the late penalties shall be entirely allocated to the performance obligation representing the provision of the platform.

Assuming that this performance obligation meets one of the criteria specified in IFRS 15 for revenue recognition over time (cf. **question 52**), the entity must, throughout the construction phase, update its estimate of the amount for which it is highly probable that a significant revenue reversal will not occur.

Example 8 (following on from example 7)

The ongoing operations services are substantially the same each year and have the same pattern of transfer to the customer (cf. **question 21**). Therefore, under IFRS 15, they constitute a series of distinct services (each period of service is distinct from the other periods) which is accounted for as a single performance obligation.

Given the above, allocating the remaining amount of the transaction price (i.e. €200k a year for five years) to this second performance obligation is straightforward.

However, it is much more difficult to determine how the entity should account for the variability resulting from the fact that the consideration is updated in line with the index of salaries in the IT sector: in order to recognise revenue in accordance with IFRS 15, does the entity need to reallocate the contractually stated amounts to the various periods of service?

The answer is no. In a multi-year contract, updating prices in line with an inflation index is usually intended to ensure that the contractually stated prices remain in line with the customary selling prices for similar goods or services provided separately during that period. This is indeed the case here: for example, if we consider the increase in the amount due for the second year, we see that it reflects the impact on the entity's cost structure of salary changes between the signing of the contract and the second year of operations in the price of the operations services provided in the second year. The entity would most probably take account of this impact if it were called upon to determine a price for the provision of similar services under a new contract during this second year.



49. Step 4: how should changes in the transaction price be accounted for?

[IFRS 15.87-90]

The transaction price may change over the contract term, as a result of either a contract modification (cf. **question 14**) or a new estimate of variable consideration (cf. **question 30**).

In the former case, the provisions of IFRS 15 on contract modifications apply (cf. **question 15**).

In the latter case, IFRS 15 specifies that the new estimate shall be allocated to the performance obligations in the contract on the same basis as the allocation carried out at contract inception, including in cases where an amount of consideration is variable (cf. **questions 42, 47 and 48**). In practice, this means that additional revenue (or a reduction in revenue) shall be recognised immediately if it is allocated to a performance obligation that has already been satisfied at the time of the price change. The objective of this is to ensure that the entity has recognised the revenue relating to each performance obligation as if the final transaction price had been known from the outset.

In the specific case where a re-estimation of the transaction price (due to a re-estimation of variable consideration) follows a contract modification, the entity must consider whether the new estimate relates to variable consideration promised before the contract modification. If it does, and if the contract modification was accounted for prospectively (i.e. as if it were a termination of the existing contract and the creation of a new contract that includes the goods or services yet to be delivered under the original contract and as a result of the modification), the entity shall allocate the change in the transaction price to the performance obligations identified in the contract before the modification. In effect, this means that revenue from performance obligations that have already been satisfied at the time of the price change is adjusted immediately to take account of the change.

In all other cases in which the modification was not accounted for as a separate contract, an entity shall allocate the change in the transaction price to the performance obligations in the modified contract (i.e. the performance obligations that were unsatisfied or partially unsatisfied immediately after the modification).



STEP 5: SATISFACTION OF THE PERFORMANCE OBLIGATIONS

[QUESTIONS 50 TO 61]



50. Step 5: when should an entity recognise revenue?

[IFRS 15.31-32]

An entity shall recognise revenue when (or as) it satisfies a performance obligation (cf. **question 16**) by supplying a promised good or service (i.e. transferring an asset) to the customer; an asset is transferred when (or as) the customer obtains control of the asset (cf. **question 51**).

Thus, an entity shall determine when to recognise revenue at the level of each performance obligation. Within a contract, revenue allocated to one performance obligation (cf. **question 42**) may need to be recognised over time, whereas revenue allocated to another performance obligation may need to be recognised at a point in time.

Under IFRS 15, an entity may not automatically conclude that revenue shall be recognised over time due to the nature of the goods or services in question; rather, it depends on the pattern of transfer of control to the customer. If an entity does not satisfy a performance obligation over time (cf. **question 52**), this means that it satisfies the performance obligation at a point in time (cf. **question 61**).

51. Step 5: how is control defined?

[IFRS 15.33-34]

IFRS 15 defines control of an asset (whether a good or a service) as the ability to direct the use of the asset (i.e. it has a present right) and to obtain substantially all of the remaining benefits of it (i.e. potential cash flows, whether inflows or savings in outflows, that can be obtained directly or indirectly by using, reselling, exchanging or holding the asset, or pledging it to secure a loan). Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset.

The IFRS 15 Basis for Conclusions states that control should be assessed from the perspective of the customer (even though assessing control from the perspective of the entity would lead to the same conclusion in many situations – cf. IFRS 15.BC121). This perspective minimises the risk of an entity recognising revenue that does not coincide with the transfer of goods or services to the customer.

In addition to the definition of control, the Standard also includes a list of indicators to help an entity to determine the point in time at which control is transferred to the customer (when it is not transferred over time). These indicators represent attributes of control that may be more or less relevant in different situations (cf. **question 61**).

In practice, it can be difficult to assess control where the asset transferred is a service. IFRS 15 includes a number of criteria that can be used to determine whether control is transferred to the customer over time (cf. **question 52**). The Standard notes that one of these criteria is typical of many service contracts: the asset created by the entity's performance is immediately consumed by the customer.

Finally, when evaluating whether a customer obtains control of an asset, an entity shall consider any agreement to repurchase the asset (cf. **question 79**).

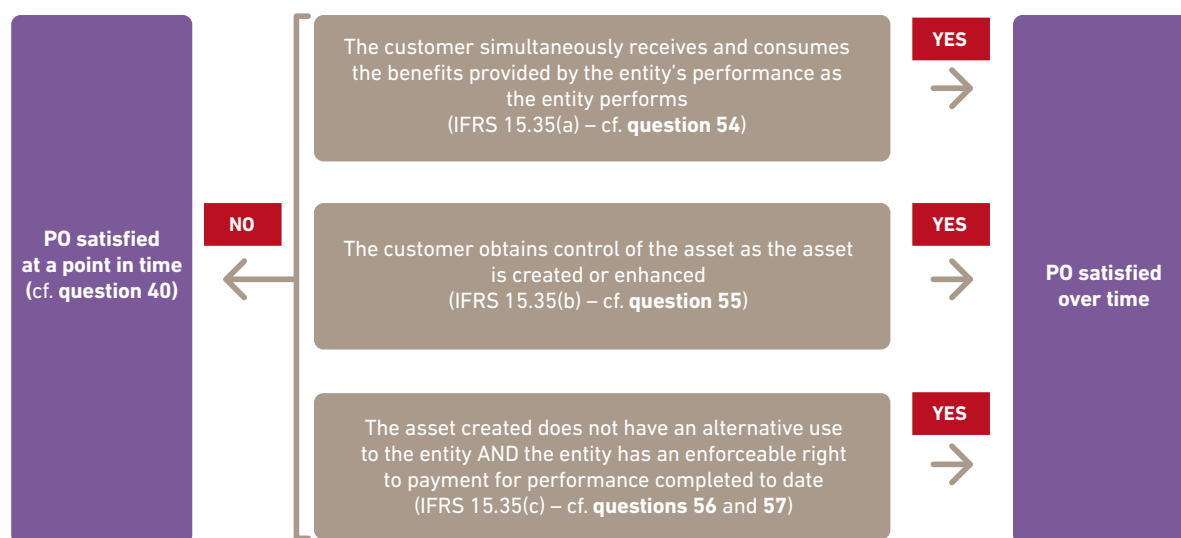


52. Step 5: how to determine whether revenue allocated to a performance obligation should be recognised over time?

[IFRS 15.35]

To determine whether revenue allocated to a performance obligation should be recognised over time, IFRS 15 requires an entity to consider three criteria. If any one of them is met, this means that control is transferred to the customer over time, and thus revenue shall likewise be recognised over time. The entity shall assess this at contract inception.

Figure 14



These criteria shall be applied to all goods and services sold by the entity, irrespective of sector.

However, the Basis for Conclusions suggests that these criteria are likely to be more relevant in certain situations (cf. IFRS 15.BC125, IFRS 15.BC129 and IFRS 15.BC132):

- “typical” (i.e. relatively simple) service provisions should generally be accounted for over time under criterion 35(a);
- the second criterion (35(b)) applies when the customer clearly controls work in progress;
- the last criterion (35(c)) should be considered, by default, when the two previous criteria are not met (for example, services tailored to a customer that ultimately result in the delivery of a report, or the construction of a complex industrial asset on the entity's premises).



53. Step 5: how should the criterion for the transfer of control over time that applies to some provisions of service be applied?

[IFRS 15.35(a) & B3-B4]

As a reminder, for this criterion to be met the customer must simultaneously receive and consume the benefits provided by the entity's performance as the entity performs (cf. **question 52**).

This criterion thus typically applies to contracts for the provision of routine and/or recurring services (e.g. cleaning services, transaction processing for the customer, supplying qualified personnel, etc.).

The IFRS 15 application guidance explains how to apply this criterion when it is not so easy to readily identify whether it is met. Thus, a performance obligation is satisfied over time if the entity determines that another entity would not need to substantially re-perform the work that the entity has completed to date, if that other entity were to fulfil the remaining performance obligation to the customer. When carrying out this analysis, the entity shall:

- a) disregard potential contractual restrictions or practical limitations that would prevent the entity from transferring the remaining performance obligation to another entity: in other words, the entity shall work on the (hypothetical) assumption that nothing would prevent another supplier from taking over the contract;
- b) presume that another entity fulfilling the remainder of the performance obligation would not have the benefit of any asset that is presently controlled by the entity and that would remain controlled by the entity if the performance obligation were transferred to another entity.

Thus, in practice, this criterion would not apply to (for example) consulting services that ultimately result in the delivery of a professional opinion or a report. More generally, this criterion would not apply to any performance that gives rise to work in progress (whether tangible or intangible) over the contract term.

54. Step 5: how should the criterion for the transfer of control as the asset is created be applied?

[IFRS 15.35(b) & B5]

As a reminder, for this criterion to be met the entity's performance must create or enhance an asset (for example, work in progress) that the customer controls as the asset is created or enhanced (cf. **question 52**).

This criterion applies particularly to situations in which the control of the asset being created (or enhanced) is clearly transferred to the customer, either because the entity is building an asset on the customer's land (or installing equipment on the customer's production line), or because the entity is enhancing (i.e. maintaining, upgrading, repairing, etc.) an asset that already belongs to the customer.

In situations where the analysis is less straightforward, the entity will need to refer back to the definition of control (cf. **question 51**) and, where necessary, to the indicators provided in the Standard in order to determine at what point control is transferred (as these indicators are attributes of control) (cf. **question 61**).

Thus, in practice, if it can be demonstrated that the customer has the ability to direct the entity during the contract term (e.g. by changing the technical specifications of the good or service) and to obtain the benefits from the work in progress (e.g. because the contract specifies that ownership of work in progress is transferred automatically), the criterion is met and control is transferred over time.



However, the entity should check that control of work in progress is actually transferred, and this is not merely a protective right granted to the customer.



An entity may sometimes carry out preliminary tasks to enable it to provide the good or service promised in the contract (e.g. the design and manufacture of specialised components to be integrated into the customer's assembly line as part of an upgrade, which constitutes a single performance obligation). In this case, criterion 35(b) of IFRS 15 cannot be met until the entity begins to transfer control of the asset to the customer (in this case, on commencement of the upgrade work carried out on the customer's premises). In practice, this means that the entity would recognise work in progress during the preliminary phase of manufacturing the components, and would not recognise revenue until the point at which it commences work on the customer's premises (with a catch-up adjustment at the point when control of the specialised components is transferred).

Note: we are here assuming that criterion 35(c) is not met, as the entity has no right to payment (cf. **question 56**).

55. Step 5: when the transfer of control over time is not clear, how should the final IFRS 15 criterion, which consists, firstly, of determining that the created asset has no alternative use for the entity be applied?

[IFRS 15.35(c)-36 & IFRS 15.B6-B8]

When the two first criteria for the transfer of control over time are not satisfied, an entity should analyse whether the final criterion listed in IFRS 15.35(c) is fulfilled (cf. **question 52**). This criterion depends on two cumulative conditions, the first of which requires a demonstration that the good or service transferred to the customer has no alternative use for the entity. The second condition is discussed in **question 56**.

To conduct this analysis, the good or service must be considered, at contract inception, in its final state. Thus the fact that a good or service is not customised until the end of the production process does not mean that the good or service necessarily has an alternative use for the entity. In other words, the basic design of the asset may be the same for all contracts, and the significant customisation may occur at a later stage in production, without preventing the entity from concluding that, in its final state, the asset has no alternative use for the entity.



The Standard also indicates that an entity must take account of contractual and practical restrictions preventing it from readily directing the good or service to another customer:

- **contractual restrictions:** this will be the case if the asset is clearly identified in the contract and the customer has the right to prohibit it from being directed to another customer (for example: sale of an apartment that is part of a real estate complex). However, contractual terms preventing an entity from readily directing an asset to another use must be substantive for the asset not to have an alternative use to the entity;

A contractual restriction is substantive if a customer could enforce its rights to the promised asset if the entity sought to direct the asset for another use. In contrast, a contractual restriction is not substantive if, for example, an asset is largely interchangeable with other assets that the entity could transfer to another customer without breaching the contract and without incurring significant additional costs that otherwise would not have been incurred.

- **practical limitations:** a practical limitation exists if an entity would incur significant economic losses to direct the asset for another use (for example, because the entity would incur significant costs to modify the asset, or would only be able to sell the asset at a loss).

Other examples can be considered: design specifications that are unique to a customer (i.e. significant costs to rework the asset), an asset that can only be used by a single customer, negative consequences of a severe manufacturing delay (e.g. significant procurement or production delays i.e. significant “lead time”, weak monthly production, or substantial penalties payable to the initial customer), etc.

A case-by-case approach is required before reaching any conclusion.

This analysis is completed at contract inception and should not be updated, unless the parties approve a contract modification that substantially modifies the performance obligation in question.

56. Step 5: when the transfer of control over time is not clear, how should the final IFRS 15 criterion, which consists, secondly, of determining that the entity has an enforceable right to payment for performance completed to date be applied?

[IFRS 15.35(c)-37 & IFRS 15.B9-B13]

When the two first criteria for the transfer of control over time are not satisfied, an entity should analyse whether the final criterion listed in IFRS 15.35(c) is fulfilled (cf. **question 52**). This criterion depends on two cumulative conditions, including a demonstration (after showing that the good or service has no alternative use – cf. **question 55**) that the entity has an enforceable right to payment for performance completed to date at all times throughout the duration of the contract (cf. **question 9** for the definition of “enforceable”).

Hence, if the first condition of this criterion (or the other criteria listed in IFRS 15) is not satisfied, control will be assumed to transfer to the customer at a point in time, and the revenue cannot be accounted for over time. In other words, it is not necessary to investigate whether an enforceable right to payment exists if the good or service, in its final state, has an alternative use for the entity (i.e. the good or service is generic).

An entity has an enforceable right to payment for performance completed to date if it is entitled, at all times throughout the duration of the contract, to an amount that at least compensates it for completed performance to date if the contract is terminated by the customer or another party for reasons other than the entity’s failure to perform as promised. The cases of termination considered by the Standard therefore include termination for the convenience of the customer (i.e. the customer decides during the contract that it no longer wants the asset), customer default, termination for public interest reasons (public customers), etc.



The analysis is generally theoretical, because termination for reasons other than the entity's failure to perform as promised are rare in practice.

Further, in March 2018 the IFRS IC clarified that the probability that the customer will exercise this right is not relevant to the analysis.

If the customer has no right to terminate the contract for a reason other than the entity's failure to perform as promised, the entity might be entitled to oblige the customer to accept the goods for which it has contracted, and to pay the agreed consideration (i.e., to enforce the performance of contract, where the entity has not failed to perform the contract as promised). Under these circumstances, there is a right to payment for performance to date, and the second condition of criterion 35(c) is satisfied.

56.1 Amount obtained from the customer for termination for reasons other than the entity's failure to perform

Where the customer has a right to terminate the contract for a reason other than the entity's failure to perform as promised, an entity must assess the amount that it would be entitled to obtain from the customer under the contract for the work completed at the termination date.

An amount that would compensate an entity for performance completed to date (i.e. an amount that would meet the right to payment criterion of IFRS 15) would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the entity's costs to date to fulfil the performance obligation, plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract is terminated.

IFRS 15 states that reasonable compensation need not equal the expected profit margin if the contract was fulfilled as promised (because the value transferred to the customer in a contract terminated early may not be proportionate to the value which would have transferred had the contract been completed), but an entity should be entitled to compensation for either of the following amounts:

- a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or
- b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

To conduct this analysis, an entity should use its own judgement to assess the return that would be considered reasonable.

There is also an area of judgement concerning how to assess completed performance to date throughout the duration of the contract (since the right to payment is assessed in relation to this performance, as measured throughout the contract). This question takes us back to the issue of measuring progress for a performance obligation satisfied over time (cf. **question 57**).

Determining the extent to which an entity will be entitled to an amount representing costs incurred to date plus a reasonable margin therefore often calls for judgement, and for a careful analysis of the termination clauses (for reasons other than the entity's failure to perform) or any relevant legal documentation (cf. **question 56.2**).



The amount due from the customer in application of a termination clause is not the only element to be taken into account when assessing whether an entity is entitled to an amount approximating the selling price of the goods and services transferred to date. In practice, an entity must also take account of any non-refundable payments already received from the customer at the time of termination. However, in conducting the analysis, it must ignore any amounts that are not definitively acquired, even if these payments are contractually provided for in the payment schedule agreed between the parties. In other words, the analysis of the right to payment must not take account of the payment milestones in the contract unless the sums received from the customer are non-refundable in the event of termination by the customer for reasons other than the entity failing to perform as promised in the contract.

In March 2018 the IFRS IC further clarified the payments to be taken into account when analysing the enforceable right to payment: it is a payment to which the entity is entitled for performance under an existing contract that is relevant when determining the enforceable right to payment for performance completed at a given date. Hence, the analysis must ignore any sums that an entity could obtain from reselling the asset to another customer, if the first customer is only obliged to indemnify the entity for the loss of profit that might be experienced in the resale. This is because, in this situation, the first customer does not in every case have an obligation to pay the entity for the performance completed to date.

Example 9

An entity enters into a contract with a customer for the supply of a machine customised for that customer, in a period of 12 months.

The contractual payment schedule is as follows:

- > on contract signature: 20% of the contract price;
- > every 3 months for 12 months: 10% of the contract price (i.e. 40% of the contract price);
- > on acceptance of the completed machine (acceptance necessitating the successful conclusion of contractually required performance tests): the balance of the contract price (or 40%).

The payments are non-refundable except in the event that the entity fails to perform the contract as promised.

In the event of termination of the contract by the customer, the entity is entitled to retain the payments received to date.

In order to determine whether the performance obligation corresponding to the supply of the machine is satisfied at a point in time or over time, the entity examines whether it has an enforceable right to payment at all times for performance completed to date (here, the entity has concluded that the performance obligation does not meet the criteria in IFRS 15.35(a) and IFRS 15.35(b)).

The entity observes that at various times during the contract, the cumulative amount of consideration paid by the customer may be less than the selling price of the partially-completed equipment at this time. Consequently, even if the payments made by the customer are non-refundable, the cumulative amount of these payments does not correspond, at all times throughout the duration of the contract, to at least the amount necessary to compensate the entity for performance completed to date. The entity therefore concludes that the performance obligation does not meet the criterion of IFRS 15.35(c) and that, therefore, the performance obligation is satisfied at a point in time (none of criteria set out in IFRS 15.35 being satisfied).

Should the entity have a right to payment at all times throughout the duration of the contract in accordance with these principles, it must also determine that this right is enforceable before it can conclude that the criterion is met.



56.2 Enforceable nature of the right to payment

A right to a payment where a contract is terminated for a reason other than the entity's failure to perform as promised is enforceable if the applicable legislation enables enforcement of this right (the concept of an "enforceable" right is the same as that applied in step 1 to determine whether a contract exists within the meaning of IFRS 15 – cf. **question 9**). It is not therefore necessary for the entity's right to payment for performance completed to date to be a present unconditional right (i.e. a receivable – cf. **question 84**), as such a right generally only becomes unconditional when a specified stage identified in the contract is reached, or when the performance obligation is satisfied.

In assessing the existence of and the enforceable nature of a right to payment for performance completed to date, the entity shall consider not only the contractual terms but also any legislation or legal precedent that could supplement or override those contractual terms. Hence, in practice, even if the contract does not mention the customer's right to terminate the contract for a reason other than the entity's failure to perform, if legislation (or legal precedent) gives the customer such a right, the analysis must take account of the amount that would be obtained by the entity if this right to terminate was exercised (cf. **question 56.1**). Similarly, if legislation (or legal precedent) calls into question the right to payment mentioned in the contract, the entity must take account of this in assessing the enforceable nature of the contractual right.

In March 2018, the IFRS IC published a decision concerning the case of a real estate construction contract in a legal environment where the courts had authorised the termination of similar contracts for reasons other than the entity's failure to perform (for example, when it had been shown that the customer – a private individual – was not financially able to satisfy the conditions of the contract), even where the customer had no contractual right of termination. At the time of termination, the entity was merely entitled to termination compensation (not an amount corresponding to the selling price of the performance completed to date). In this instance, the IFRS IC concluded that the enforceable right to payment had not been evidenced.

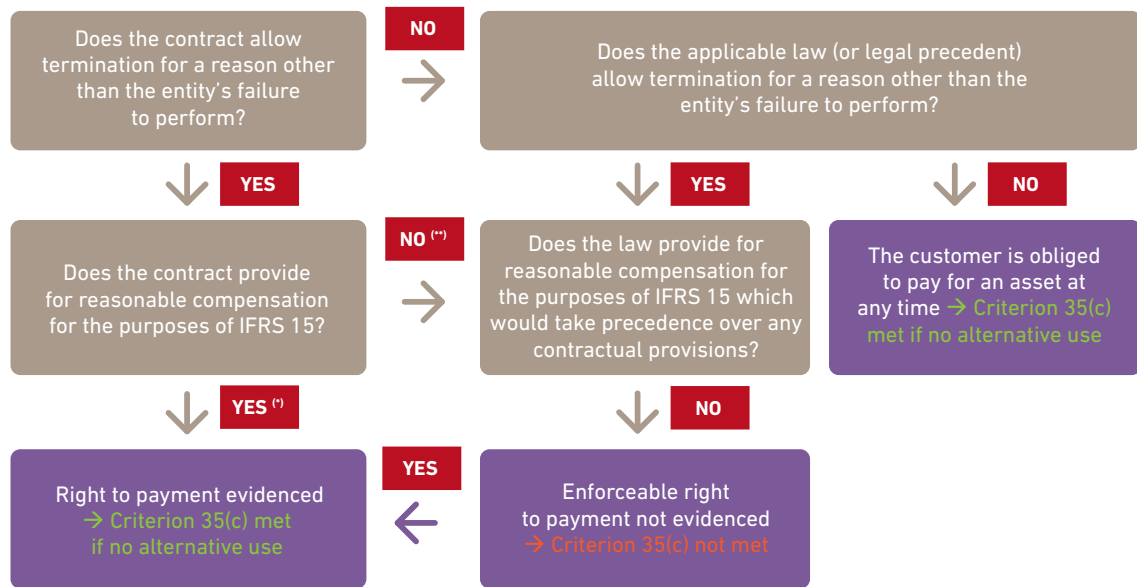
A legal analysis of the contract, taking account of all its characteristics – in terms of regulation and legal precedent – in the legal environment concerned, must therefore be conducted in order to prove the existence of any such right, and to assess its enforceability.

In March 2018, the IFRS IC indicated that an entity has no need to carry out exhaustive research into the decisions that make up the case law. However, it would be inappropriate to ignore the relevant existing legal precedents, or to anticipate decisions that might be made (or not) in the future.

The Committee also indicated that only the enforceability of the right to payment needs to be analysed. There is no need to take account of the probability that the entity will exercise the right.



Figure 15



^(*) Particular attention needs to be paid to the situations (likely to be rare in practice) where the law (or legal precedent) might suggest that the contractual right to payment is not enforceable.

^(**) In the event that the contract allows termination for a reason other than the entity's failure to perform, the law may specify/clarify the existence of a right to payment when the contract is not explicit in terms of compensation, or if the (favourable) legislation takes precedence over the (unfavourable) contractual clauses.





In November 2016, the TRG (cf. **question 98**) discussed the relationship between the timing of the customisation of a good, the right to payment and the measure of progress. This is particularly important when progress towards completion of a performance obligation satisfied over time is measured on a costs basis (cf. **question 57**).

In practice, it can be considered at the start of a given contract that the criterion 35(c) is satisfied (because the good, in its final state, is specific, and because the entity has an enforceable right to payment throughout the duration of the contract) without this implying that the activities conducted at contract inception contribute to the progress of the contract towards completion (and hence to the recognition of revenue over time).

Such a case may arise when manufacturing the asset requires the supply and production of generic parts which are not physically integrated into the customer's specific order until a certain stage in the production process.

Where the entity measures progress by with a cost-to-cost method, this means that the generic parts purchased or manufactured are accounted for in inventories in accordance with IAS 2 until they are integrated into the order (so no revenue is recognised at this stage).

Recognition of revenue over time begins when generic parts are removed from inventories for use in the manufacture of the good sold (creating an asset with no alternative use and covered by an enforceable payment right).

The TRG's discussions clarified that assessing the right to payment must take account of performance completed to date, which should coincide in principle with how an entity measures progress towards completion. Hence, it would not be necessary for the right to payment to compensate the entity for the costs incurred during activities prior to the customisation of the good, if the customer were to terminate the contract before the customisation phase began, in order to conclude at contract inception that the criterion 35(c) is met (it is, however, necessary for this right to allow for compensation, throughout the duration of the contract, of the proportion of the costs incurred that the entity considers as to be reasonably included in the measure of progress, if the customer were to terminate the contract for a reason other than the entity's failure to perform as promised).

57. Step 5: how is progress for a performance obligation satisfied over time measured?

[IFRS 15.39-45 & IFRS 15.B14-B19]

For each performance obligation satisfied over time (cf. **question 52**), revenue must be recognised over time. To do so, an entity shall measure the progress towards complete satisfaction of the performance obligation.

The measurement of progress has the objective of faithfully depicting an entity's performance in transferring control of the goods or services promised to the customer (that is, the extent to which the performance obligation is satisfied).

An entity shall apply a single method of measuring progress for each performance obligation satisfied over time, and shall apply that method consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity shall remeasure its progress towards complete satisfaction of each performance obligation satisfied over time.



In July 2015 the TRG (cf. **question 98**) clarified that the principle of applying a single method of measuring progress for a given performance obligation is also applicable to a combined performance obligation, i.e. one that contains multiple non-distinct goods or services (cf. **question 16**). Hence, it is not appropriate to apply several methods depending on the stage of performance, even if these methods all belong to one of the two major categories of methods presented below (output methods vs input methods), for example a method measuring progress on the basis of hours expended, and a method measuring progress on the basis of labour costs incurred. Further, the TRG observed that it can be challenging to identify a single measure of progress for a combined performance obligation. The TRG believes that judgement is required, and that entities should consider the reasons why they assessed that the goods or services are not distinct, and the nature of the overall promise. If it appears that a single method of measuring progress towards completion is not appropriate for the combined performance obligation, this might – in some cases – be an indicator that the step 2 analysis is incorrect and that some goods and services are in fact distinct.

IFRS 15 lists two main categories of methods of measuring progress:

- **output methods:** revenue is recognised on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Examples of these methods include appraisals of results achieved, important stages reached, an estimate of the time elapsed or a calculation of the units produced or delivered. However, these output methods have certain disadvantages which may prevent their use in practice (cf. **question 59**). A practical expedient is offered under certain conditions (cf. **question 58**);
- **input methods:** revenue is recognised on the basis of the entity's efforts or inputs to date (for example, resources consumed, labour hours expended, costs incurred, time elapsed 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 the entity to recognise revenue on a straight-line basis. The use of these methods requires an entity to exclude from an input method the effects of any inputs that do not depict the entity's performance in transferring control of goods or services to the customer (cf. **question 60**).

An entity must apply judgement to identify an appropriate method of measuring progress towards completion. As the Basis of Conclusions on IFRS 15 makes clear, an entity does not have a "free choice" (cf. IFRS 15.BC159). It must take account of the nature of the promised good or service, while bearing in mind the objective set out above (i.e. depicting the entity's performance in transferring control of the promised goods or services to the customer). These principles can be illustrated through the following two cases:

- a cost-to-cost method of measuring progress for a performance obligation would generally be relevant for aircraft maintenance (i.e. costs incurred to date compared with total expected costs over the duration of the performance obligation), even if the obligation is invoiced by flight-hour. This is because control of the service is transferred to the customer as it is performed (i.e. with each actual intervention on the aircraft, it being assumed here that the aircraft remains in the customer's control throughout the contract) and not in accordance with the pattern of use of the aircraft by the customer;
- when the entity's obligation consists of standing ready to perform a service (a "stand-ready obligation") rather than the service itself, a linear method of measuring progress towards completion would generally be appropriate (i.e. pro rata temporis). An example would be a performance obligation consisting of making a sports club available to a customer. The remaining quantity of services to which the customer is entitled is indeed independent of the quantity of services he has already received.

In January 2015 the TRG (cf. **question 98**) clarified that a linear method is not appropriate to a stand-ready obligation if the benefit of the service is not spread evenly throughout the contract (for example, an annual contract to clear snow from an airport runway, where the customer receives the benefits of the service only in winter).

An entity shall recognise revenue for a performance obligation satisfied over time only if the entity can reasonably measure its progress towards complete satisfaction of the performance obligation, i.e. if it has the reliable information that would be required to apply an appropriate method of measuring progress.

Where an entity is not able to reliably measure the outcome of a performance obligation (for example, at the start of the contract), but the entity expects to recover the costs incurred in satisfying the performance obligation, it must only recognise revenue to the extent of the costs incurred until it is able to reasonably measure the outcome of the performance obligation.

58. Step 5: what is the practical expedient offered in IFRS 15 for the recognition of revenue over time?

[IFRS 15.B16]

If an entity has a right to consideration from 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 service contract in which an entity bills a fixed amount for each hour of service provided), the entity may recognise revenue in the amount to which the entity has a right to invoice.

In July 2015, the TRG (cf. **question 98**) clarified that this practical expedient can be also applied in the case of a long-term contract to provide goods or services in which the price per unit changes over the duration of the contract (for example, an IT contract with rates that decrease as the entity passes on the benefits of the learning curve to the customer, or an electricity contract where the annual rate reflects the market price of electricity). An entity must nevertheless exercise judgement, taking account of the facts and circumstances, to assess whether use of this practical expedient to measure progress is possible. In particular, it may be difficult to decide whether the practical expedient can be applied in cases of advance payments, or significant retrospective price reductions.

In terms of disclosures, and by way of simplification (in addition to the expedient presented above), an entity need not provide the information required by IFRS 15 about the transaction price allocated to unsatisfied performance obligations (i.e. the "backlog" under IFRS 15 – cf. **question 88**) if progress towards these performance obligations is measured using the practical expedient set out above.



59. Step 5: can the technical milestones approach be used?

[\[IFRS 15.B15\]](#)

Among the appropriate methods of measuring progress towards completion, IFRS 15 mentions output methods (cf. **question 57**), which include the technical milestones method. The Standard states that when an entity applies a method to measure progress, it must include in its measurement all the goods and services for which control is transferred to the customer when it satisfies the performance obligation. Hence, a method based on outputs would not provide a faithful depiction of the entity's performance if the outputs selected fail to measure some of the goods or services for which control has transferred to the customer.

The technical milestones method consists of recognising revenue over time whenever a "milestone" is reached (whether contractual or defined by the entity for the purposes of monitoring the contract). This method means that no revenue is recognised between two milestones, even if the entity carries out work to satisfy the performance obligation between them. Hence, the works completed after a milestone is passed are accounted for in works in progress, until a new milestone is reached.

For IFRS 15, such a method (like methods based on the number of units delivered) would not faithfully depict an entity's performance in satisfying a performance obligation if, at the end of the reporting period, the entity's performance has produced work in progress or finished goods controlled by the customer that are not included in the measurement of the output (and thus in the measurement of progress).

In April 2016, the TRG (cf. **question 98**) was asked whether control of a good or service underlying a performance obligation could be gradually transferred to the customer at discrete points in time (that is, at a number of precise moments, rather than strictly continuously, during the period over which the performance obligation is satisfied). TRG members clarified that the transfer of control over time, in application of any one of the Standard's criteria (cf. **question 52**), implies that control cannot transfer at discrete points in time. Consequently, an appropriate method of measuring progress should not lead an entity to account for significant work in progress that is associated with the entity's performance under a contract with a customer.

In practice, the technical milestones method (or any other output method with similar consequences) is not therefore permitted under IFRS 15, unless it can be shown that work in progress is immaterial at all times over the duration of the performance obligation. The amount of this work in progress should also be immaterial to the entity for all the performance obligations for which the technical milestones method is used.

60. Step 5: what contract costs cannot be taken into account for measuring progress?

[\[IFRS 15.B18-B19\]](#)

Among the appropriate methods of measuring progress towards completion, IFRS 15 mentions input methods (cf. **question 57**), which include the "cost-to-cost" method (under which progress is measured on the basis of the ratio of the costs incurred to date to satisfy a performance obligation over the total estimated amount of costs that will be incurred).

However, there may not be a direct and proportional relationship between an entity's inputs and the transfer of control of goods or services to a customer. Therefore, an entity must exclude the effects of any inputs that do not depict the entity's performance in transferring control of goods or services to the customer. These adjustments thus affect the margin recorded at the end of each reporting period over the lifetime of the performance obligation (cf. **question 67**).



Therefore, when using a cost-based input method, an adjustment to the measure of progress may be required in the following circumstances:

- a) **significant inefficiencies** (or significant wasted materials): an entity may encounter difficulties in performing an obligation leading it to incur significant inefficiencies that are not reflected in the contract price² (for example, the costs of unexpected amounts of wasted materials, labour or other resources that were incurred to satisfy the performance obligation). Under these circumstances, an entity must exclude these significant inefficiencies from the cost-to-cost ratio (both the numerator and denominator). This means that the recognition in expenses of these inefficiencies (unlike the costs that reflect the transfer of control to the customer) does not result in the recognition of additional revenue at the time they are recorded;
- b) **“uninstalled materials”** (for which there is no proportional relationship between the costs incurred and progress towards performance of the obligation): under certain conditions (see below), the cost of these materials is also excluded from the cost-to-cost ratio. Nonetheless, revenue is recognised, but only to the extent of the costs incurred (i.e. no margin is recognised for these materials at that point). The Standard states that such a measure of progress is appropriate if the entity expects at contract inception that all of the following conditions will be met:
 - i. the good is not distinct;
 - ii. the customer is expected to obtain control of the good significantly before receiving services related to the good;
 - iii. the cost of the transferred good is significant relative to the total expected costs to completely satisfy the performance obligation;
 - iv. the entity procures the good from a third party and is not significantly involved in designing and manufacturing the good (but the entity is acting as a principal – cf. **question 70**).

IFRS 15 does not clarify when the margin on these uninstalled materials should be accounted for. In our view, an entity can either decide to recognise all the margin once the good is installed, or allocate the margin to other elements of the performance obligation and recognise it over time, in line with the progress of these other elements.

Example 10: significant inefficiencies

An entity concludes a contract with a customer for the development, production and installation of a specific item of equipment in three years' time for the price of €500m. The contract is considered as including a single performance obligation satisfied over time. Progress is measured using a cost-to-cost method.

Given the nature of the activity, it appears normal and inevitable that there will be some losses of materials, labour or other resources. This has been taken into account in the initial project cost estimated by the entity (estimated at a total of €400m) and in the price agreed with the customer.

This contract therefore has a margin on completion of €100m.

Following a major IT incident, the entity accidentally loses some of the development study data, and is obliged to recreate them during the first year. The associated cost overrun is estimated at €40m. The total costs incurred at the end of the first year, including this overrun, stand at €160m. Aside from this event, there has been no significant deviation from the initial budget forecast.

Given its origin and magnitude, the €40m overrun is regarded as representing a significant inefficiency, and is therefore excluded from the calculation of progress.

² In our view, the concept of significant inefficiency should be distinguished from the costs that an entity incurs repeatedly because the activity it must carry out to satisfy the performance obligation requires complex iterative processes, with some uncertainty as to the number of iterations necessary (which would logically be reflected in the selling price).



At the end of the first year, the calculation of the percentage of completion is as follows:

$$(\text{€}160\text{m} - \text{€}40\text{m}) / (\text{€}440\text{m} - \text{€}40\text{m}) = 30\%$$

Revenue recognised at the end of the first year is therefore:

$$30\% \times \text{€}500\text{m} = \text{€}150\text{m}$$

The gain (loss) recognised at the end of the first year is therefore:

$$\text{€}150\text{m} - \text{€}160\text{m} = -\text{€}10\text{m}$$

of which:

- > €30m represents the margin calculated by stage of completion (or $\text{€}150\text{m} - (\text{€}160\text{m} - \text{€}40\text{m})$); and
- > -€40m represents the cost overrun due to a significant inefficiency.

The contract remains profitable at the end of the first year (the residual contract margin to be recognised stands at: $\text{€}500\text{m} - \text{€}400\text{m} - \text{€}30\text{m} = \text{€}70\text{m}$), so no provision for an onerous contract needs to be recognised.

Example 11: uninstalled materials

In March of the year N, an entity concludes a contract with a customer for construction of a factory for the price of €100m.

The construction of the factory is the only performance obligation in the contract. It is satisfied over time, and progress is measured using the cost approach.

The total expected costs stand at €80m, including €30m of costs for relatively generic equipment (transformers) bought from a third party. The customer obtains control of these items when they are delivered to the construction site in December of year N. The factory is expected to be completed in June N+1.

Given this information (and in conjunction with the conditions listed in IFRS 15.B19), the equipment bought from third parties therefore has the characteristics of “uninstalled materials”. The transformers must therefore be excluded from the measurement of progress using a cost-to-cost method.

At the end of December N:

Costs incurred (excluding the equipment bought from a third party) stand at €20m.

Total costs (excluding the equipment bought from a third party) stand at €50m ($\text{€}80\text{m} - \text{€}30\text{m}$), so progress at December N is estimated at: $\text{€}20\text{m} / \text{€}50\text{m} = 40\%$

The entity therefore recognises €58m in revenue, calculated as the sum of:

- > $40\% \times (\text{€}100\text{m} - \text{€}30\text{m}) = \text{€}28\text{m}$ for completed performance, excluding the supply of equipment purchased from a third party; and
- > €30m (i.e. to the extent of costs) for the transfer of control of equipment purchased from a third party.

The margin resulting from the impacts accounted for in respect of this contract at the end of December N stands at: $[\text{€}58\text{m} - (\text{€}20\text{m} + \text{€}30\text{m})] / \text{€}58\text{m} = 13.8\%$.

This rate is lower than is anticipated at the end of the contract (20%) because of recognition of the equipment without margin and the relative weight of the “uninstalled materials” in the completed performance to date.



61. Step 5: what indicators can be used to determine the date of transfer of control when this does not take place over time?

[IFRS 15.38 & IFRS 15.B83-B86]

If a performance obligation is not satisfied over time (cf. **question 52**), it is satisfied at a point in time.

To determine the point in time at which a customer obtains control of a promised asset (and thus when the entity satisfies a performance obligation), the entity must first consider the definition of control (cf. **question 51**) given by IFRS 15.

In addition, an entity should 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;
- b) the customer has obtained legal title to the asset. If an entity retains legal title solely as protection against the customer's failure to pay, those rights of the entity would not preclude the customer from obtaining control of an asset;
- c) the entity has transferred physical possession of the asset. However, physical possession does not necessarily 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 (cf. **question 80**). Conversely, in some bill-and-hold arrangements (cf. **question 81**), the entity may have physical possession of an asset that the customer controls;
- d) the customer has the significant risks and rewards of ownership of the asset. An entity shall exclude any risks that give rise to a distinct 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 performance obligation to provide maintenance services related to the transferred asset);
- e) the customer has accepted the asset (see contractual customer acceptance clauses allowing a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications.). If customer acceptance is not purely formal, the entity cannot conclude that the customer has obtained control until the entity receives the customer's acceptance.





The IFRS 15 Basis for Conclusions clarifies that the list of indicators above is not a list of conditions all of which must be met before an entity can conclude that control of a good or service has transferred to a customer (cf. IFRS 15.BC155).

These indicators are often present if a customer has control of an asset. They may therefore assist entities in applying the principle of transfer of control which is the general criterion for recognising revenue in IFRS 15 (cf. **question 50**).

Therefore, the transfer of significant risks and rewards inherent in the ownership of the asset, while an important indicator for the analysis, is not necessarily sufficient for determining the date at which to recognise the revenue for a performance obligation satisfied at a point in time (it will be recalled that IAS 18 based the recognition of the revenue from goods on the transfer of the significant risks and rewards).



OTHER ACCOUNTING TOPICS

[QUESTIONS 62 TO 81]



62. Contract costs: how to account for the costs of obtaining a contract?

[IFRS 15.91-93]

An entity must recognise the costs of obtaining a contract with a customer as an asset in the following two situations:

1. if two cumulative conditions are met:
 - a) the costs are incremental (i.e. marginal): the incremental costs are those which an entity enters into to obtain the contract but that would not have been incurred if the contract had not been obtained (for example a sales commission); and
 - b) the entity expects to recover those costs (i.e. it expects that the margin on the contract and specifically anticipated contracts is sufficient to absorb these costs).
2. where the costs of obtaining a contract are not incremental, but are explicitly chargeable to the customer whether or not the contract is obtained.

Costs of obtaining a contract that are not covered by either of these headings must immediately be recognised in expenses when they are incurred.



Care is needed with regard to the nature of success fees, which might meet the definition of capitalisable incremental costs to obtain a contract. For example, a commission paid to a salesman reflecting a target based on the total turnover contracted over a given period (e.g. a year) does not meet the definition of an incremental cost to obtain a contract because it cannot be directly associated with a specific contract. It is therefore essential to properly understand how any commission paid is calculated.

Further, the Standard clarifies that the costs of obtaining a contract must be presented separately from contract assets (cf. **question 82**) and contract liabilities (cf. **question 83**).

Finally, specific disclosures are required (cf. **question 86**).

Example 12

An entity wins a competitive bid to provide consulting services to a new customer. The entity incurred the following costs in preparing the proposal and obtaining the contract:

Access to external databases:	€20,000
Travel costs for the preparation and submission of the proposal:	€10,000
Graphic design / marketing cost:	€5,000
Commissions to sales employees:	€15,000

Only the commissions to sales employees are incremental costs to obtain a contract, because the expenses for accessing external databases, travel expenses and the graphic design / marketing cost would have been incurred regardless of whether the contract was obtained. However, commissions may only be recognised as an asset if the margin expected on the contract is sufficient (i.e. if they are recoverable).

The Standard does not make any distinction between internal and external costs. All that matters is the fact of incurring costs that would not have been incurred if the contract had not been obtained.



63. Contract costs: is there a practical expedient enabling an entity not to recognise costs to obtain a contract as an asset?

[IFRS 15.94]

Yes. An entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less (cf. **question 62**).

To determine the length of the amortisation period, it is necessary to take account of anticipated contracts, if any (cf. **question 65**).

64. Contract costs: how to account for the costs to fulfil a contract?

[IFRS 15.95-98]

IFRS 15 states that the costs that relate directly to a contract (or to a specific anticipated contract) include the following:

- a) the costs of direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);
- b) the cost of direct materials (for example, supplies used in providing the promised services to a 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, and right-of-use assets used in fulfilling the contract);
- d) costs that are explicitly chargeable to the customer under the contract; and
- e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

These costs fall into two categories:

- Costs which, when incurred, contribute to transferring the promised good or service to the customer (i.e. these costs contribute directly to the entity's performance);
- Costs which, when incurred, transfer nothing to the customer immediately.

For costs in this second category, there is a question as to whether they must be recognised immediately in expenses when they are incurred, or whether they meet the definition of an asset.

In application of IFRS 15, and to answer this question, it must first be established whether these costs are covered by another Standard (for example IAS 2, *Inventories*, IAS 16, *Tangible fixed assets* or IAS 38, *Intangible assets*).

If this is the case, an entity shall account for those costs in accordance with those other standards. For example, development costs related to an intangible fixed asset generated internally for use in the fulfilment of several contracts with customers should be accounted for in accordance with IAS 38 (i.e. recognition as an asset if all the criteria listed in the standard are met).

If, under a Standard other than IFRS 15, the costs incurred by the entity cannot be capitalised, they must be accounted for in expenses when they are incurred, and it is not possible to subsequently apply the IFRS 15 criteria for recognition as assets, as presented below, in order to determine whether they will be capitalised under IFRS 15. For example, this would apply to expenditure incurred when training staff in the use of a new asset (cf. IAS 38, *Intangible assets*, paragraphs 5 and 29).

When the costs incurred to fulfil a contract fall – in the absence of an accounting treatment prescribed by another Standard – within the scope of IFRS 15 (for example, development costs incurred specifically to fulfil a contract with a customer), they must be recognised as assets only if they meet all the following conditions:

- a) they relate directly to an existing or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract, or costs of designing an asset to be transferred under a specific contract that has not yet been approved but which the entity expects to obtain);
- b) the costs generate or enhance resources³ of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future: this condition is intended to preclude an entity from deferring costs merely to smooth expected profit margins throughout a contract by allocating revenue and costs evenly over the duration of the contract. Smoothing the margins is not permitted under IFRS 15 (cf. **question 67**);
- c) the costs are expected to be recovered (the analysis may include any contract renewals that the entity expects).

In contrast, an entity shall recognise the following costs as expenses when incurred:

- a) general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract);
- b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the contract price (cf. **question 60**);
- c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (i.e. costs that relate to past performance); and
- d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

³ The concept of “resource” here mirrors that used in the definition of an asset in IAS 38.8: “An asset is a resource: (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity.” In our view, the concept of “resource” employed here by IFRS 15 implies that the entity controls this resource.





The concept of an “anticipated contract that the entity can specifically identify” can be difficult to grasp in practice, in particular when this does not refer to the renewal of an existing contract but to the expectation of obtaining a new contract with a customer. This is because, for as long as a new contract is not signed, it may be tricky to assess the extent to which costs incurred can be recovered.

In the case of a long-term contract, it often happens that during the bid process, an entity starts to incur costs associated with the fulfilment of the contract (for example, design expenses to meet the customer’s specifications). The question here is therefore when it can be considered that the costs incurred are costs to fulfil that shall be capitalised under IFRS 15. In our opinion, achieving preferred bidder status marks an important stage, enabling an entity to assume that the costs to fulfil that it incurs from that moment onwards must be accounted for as assets if the IFRS 15 criteria are met (for costs not entering within the scope of another Standard). An entity must, in every case, exercise judgement to assess the moment from which these costs must be capitalised in accordance with the provisions of IFRS 15.

The TRG (cf. **question 98**) discussed this subject in March 2015. This discussion clarified that the costs to fulfil a contract that the entity expects to conclude are accounted for as assets (provided that the criteria are satisfied) until the date at which a contract exists under IFRS 15. At the date on which the criteria for identifying a contract are considered to be met (cf. **question 10**), these costs are recognised immediately in expenses if they relate to costs incurred for goods or services transferred to the customer at that date. Otherwise, they are amortised over the period over which the remaining goods or services are delivered or performed (cf. **question 65**).

Further, the Standard clarifies that the costs of fulfilling a contract must be presented separately from contract assets (cf. **question 82**) and contract liabilities (cf. **question 83**).

Finally, specific disclosures are required (cf. **question 86**).

65. Contract costs: what rules govern the amortisation of capitalised contract costs?

[IFRS 15.99-100]

Assets representing the costs to obtain or fulfil a contract that are recognised in accordance with IFRS 15 (cf. **questions 62** and **64**) shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates.

The amortisation period may extend beyond the contract if the costs relate to multiple contracts, whether signed or anticipated (consistently with the notion of amortising an asset over its useful life as set out in IAS 38 and IAS 16).

During its November 2016 meeting, the TRG (cf. **question 98**) clarified that the practical expedient authorising the expensing of the incremental costs of obtaining a contract at the time when they are incurred (cf. **question 63**) is not applicable if taking account of anticipated contracts has the effect of extending the amortisation period beyond one year.

Determining how far the capitalised contract costs relate to goods or services beyond the initial contract may call for the exercise of judgement. In particular, in the case of a commission capitalised as an incremental contract cost, the Basis for Conclusions clarifies that amortising the asset over a longer period than the initial contract would not be appropriate in situations in which an entity pays a commission on each contract renewal that is commensurate with the commission paid on the initial contract (cf. IFRS 15.BC309).

Amortisation shall be updated to reflect any significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates (this revision shall be accounted for as a change in accounting estimate in accordance with IAS 8 – i.e. prospectively).

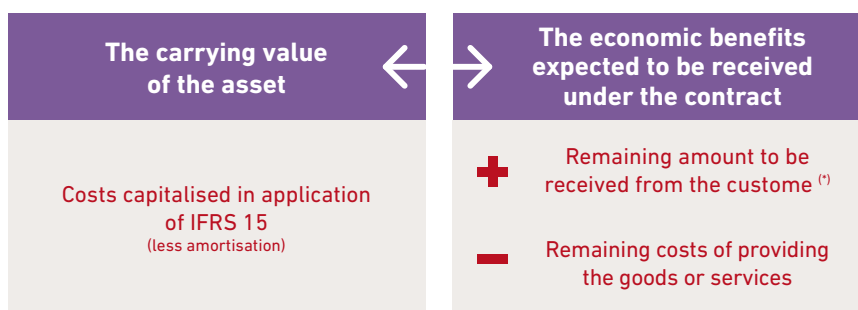
IFRS 15 is not prescriptive as to the classification of these assets in the entity's statement of financial position (but presentation in current assets seems appropriate, since they are amortised in the entity's normal operating cycle in application of IAS 1) or as to the classification of the expense resulting from their amortisation in profit or loss. Where an entity chooses to present its in profit or loss by using the function method in application of IAS 1.103, the amortisation expense of an asset representing the costs to fulfil a contract should, in our opinion, be classified under 'cost of sales'.

66. Contract costs: what rules govern the impairment of capitalised contract costs?

[IFRS 15.101-104]

Special rules apply to the impairment of contract costs recognised as an asset under IFRS 15 (see the diagram below). To conduct the impairment test, an entity must compare:

Figure 16



^(*) measured by the same method as the transaction price, except as regards:

- The **constraint on estimates of variable consideration** (cf. **question 29**): i.e. for impairment testing purposes, an entity may be led to take account of future cash flows that are not sufficiently certain for inclusion in revenue;
- **Contract extensions or renewals**: in our view, for impairment testing purposes, an entity should take account of the whole period over which it expects to receive economic benefits from the contract asset (consistent with the amortisation period – cf. **question 65**).

Before applying these provisions, an entity shall recognise any impairment loss for individual assets related to the contract that are recognised in accordance with another Standard (for example, IAS 2, IAS 16 or IAS 38). The resulting carrying amount after the impairment test described above is then recognised in the carrying amount of the cash-generating unit to which the asset belongs for the application of IAS 36, *Impairment of Assets*, to that cash-generating unit.

An impairment loss resulting from the application of the special rules set by IFRS 15 may be reversed: a reversal of the impairment loss is recognised in profit or loss when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.



67. Contract costs: what does IFRS 15 say about the smoothing of margins?

[IFRS 15.95]

The IFRS 15 provisions for the recognition of costs incurred to fulfil a contract establish the conditions under which these costs can be accounted for as assets (cf. **question 64**). Among these conditions, the Standard stipulates that the costs incurred should generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future. In practice, it is not therefore possible to defer expenses incurred that relate to goods or services already transferred to the customer.

The Basis for Conclusions to IFRS 15 clarifies, if such clarification were needed, that an entity is precluded from deferring costs merely to normalise profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract (cf. IFRS 15.BC308).

Nonetheless, where progress is measured using a cost-to-cost approach, the margin is necessarily smoothed for a given performance obligation, subject to the adjustments required in order to faithfully depict the entity's performance towards complete satisfaction of the performance obligation (cf. **question 60**).

68. Contract costs: what does IFRS 15 say about accounting for learning curve costs?

Where an entity delivers several units of the same good or service, it can incur greater costs in the early stages of a contract due to the learning curve. The impacts of the learning curve on unit production costs may be more or less significant depending on the entity's experience, the nature of its business, and so forth. When this phenomenon is an integral part of the way an entity conducts its business and negotiates its contracts with customers, it may expect to be able to spread the accounting effects of these variations over the duration of the contract.

However, as we have seen, IFRS 15 does not permit the smoothing of margin in a general way (cf. **question 67**). It is not possible to defer the recognition of costs solely in order to allocate them to units that have not yet been produced, and some costs (in particular the significant inefficiencies not foreseen in the contract price – cf. **question 60**) make no contribution to the fulfilment of the contract.

The Basis for Conclusions nevertheless does address the subject of accounting for learning curve costs (cf. IFRS 15.BC312-BC313) when:

- an entity has a single performance obligation to deliver a specified number of units; and
- the performance obligation is satisfied over time.

In practice, these conditions reflect the guidance on goods and services forming a 'series' (cf. **question 21**).

In this particular situation (i.e. a single performance obligation for distinct but similar goods or services, control of which is transferred over time), an entity must choose an appropriate method of measuring progress (cf. **question 57**). As the costs incurred at the beginning of the series are significant, a cost-based method of measuring progress would result in the entity recognising more revenue for the early units produced relative to the later units in the series. The Basis for Conclusions states that this accounting treatment is appropriate because of the greater value of the entity's performance in the early part of the contract. This is because, 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 the customer pays when it purchases more than one unit (see IFRS 15.BC314). Thus, in this particular instance, IFRS 15 can be used in practice to obtain a constant margin per unit produced.



However, the smoothing of the learning curve effect described here can only be obtained in the context of a series of goods or services for which a firm contract exists (i.e. where there are enforceable rights and obligations for both parties – cf. **question 10**). The unit margin cannot be standardised beyond this, whether in anticipation of potential additional orders expected from the customer (for example, when a framework contract foresees the possibility of successive purchase orders) or by recognising as assets the costs to fulfil a contract that do not meet the criteria for doing so (cf. **question 64**).

When the different units promised to the customer do not constitute a series under IFRS 15 (in particular because the goods are not sufficiently specific to be able to conclude that control of a good or service transfers over time in application of criterion 35(c) of the Standard – cf. **question 55**), the IASB states that the rules existing in other Standards should be applied, in particular IAS 2, *Inventories*. In practice, the costs incurred in the production of different units (including learning curve costs) are thus incorporated in the cost price of each of the units produced and hence recognised in profit or loss based on the transfer of control of each unit. The margin recorded on the later units delivered is consequently greater than the margin recorded on the first units delivered, because of the learning curve.

69. How should the loss at completion of an onerous contract be determined?

IFRS 15 does not directly address the subject of losses at completion of contracts with customers (unlike IAS 11, *Construction contracts*). The Basis for Conclusions of the Standard states that entities should apply the existing Standards (cf. IFRS 15.BC296). In particular, IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, can be used to determine whether a contract with a customer is onerous and, where applicable, how much provision to recognise. IAS 2, *Inventories*, may also apply.

IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs of a contract reflect the least net cost of exiting from the contract, which is the lower of the cost to fulfil it and any compensation or penalties arising from failure to fulfil it. As a reminder, before making separate provision for an onerous contract, an entity recognises any impairment loss that has occurred on assets assigned to that contract in application of IAS 36, *Impairment of Assets*.



An important clarification in the IFRS 15 Basis for Conclusions is that the test conducted to determine whether to recognise a provision should be applied to the whole contract, and not to distinct performance obligations (i.e. even when steps 2 and 4 of the Standard give rise to an individual margin per performance obligation).

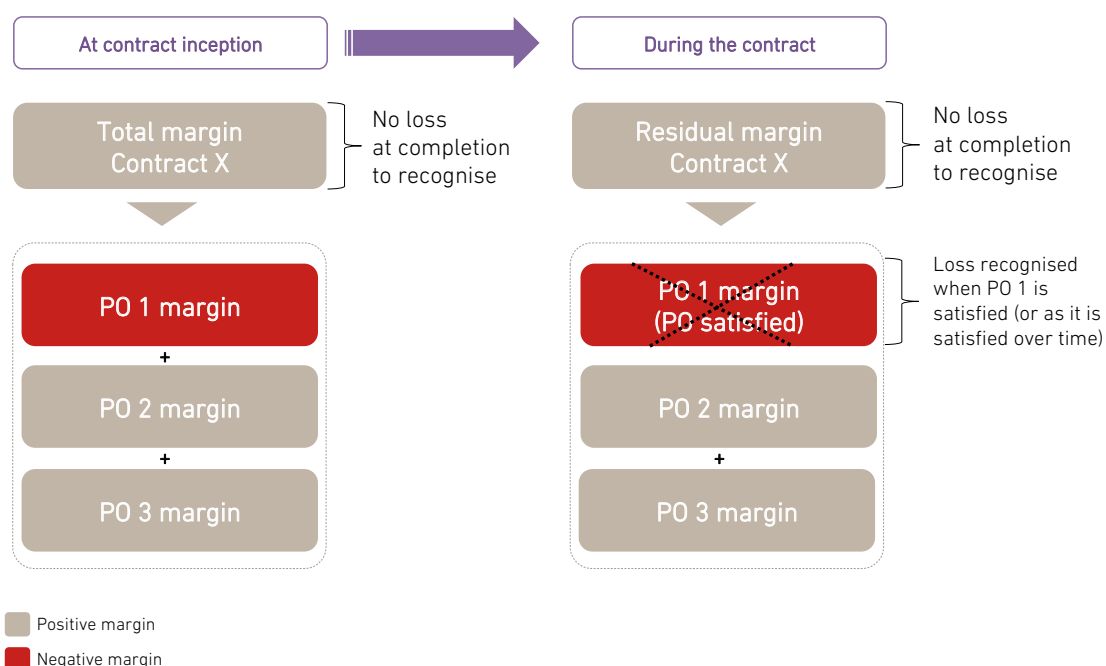
Besides, in our view, the unit of account to which the test is applied should be consistent with that used in application of step 1 of IFRS 15. In practice, this means that if one or more contracts have been combined (cf. **question 13**), it is the combination of contracts that should be analysed as a whole in order to determine whether to recognise provision for an onerous contract.

In practice, provision for an onerous contract is recognised only when the overall residual margin is (or becomes) negative, independently of the fact that the contract as defined in IFRS 15 includes performance obligations with both positive and negative margins.

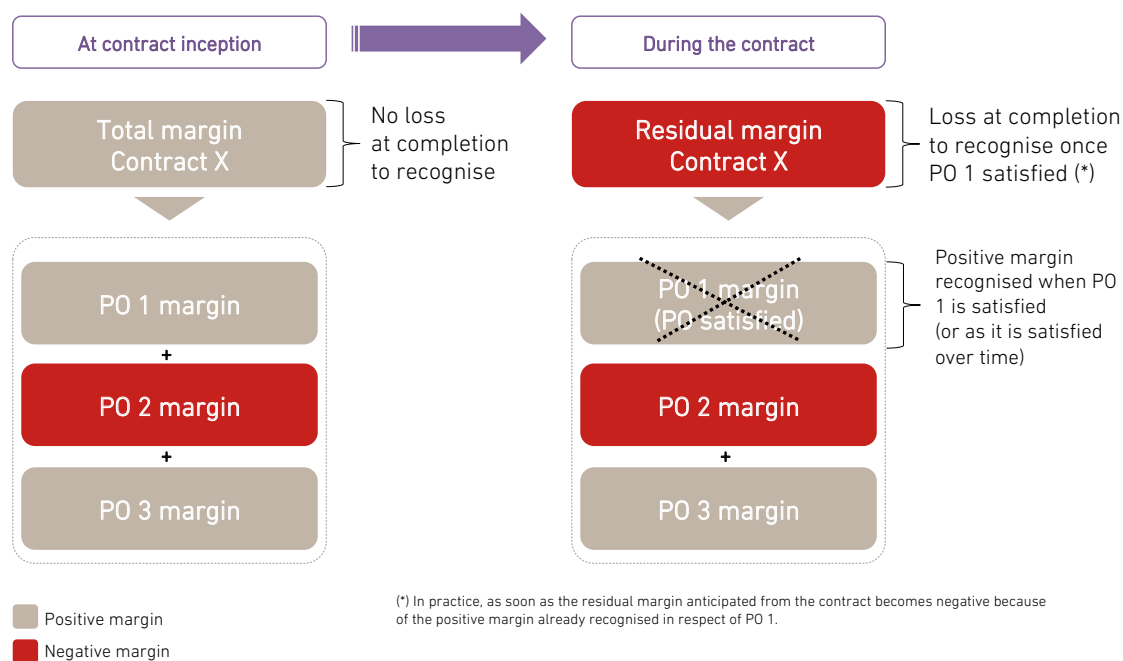


Figure 17

- a) How to account for a contract, profit-making at inception, including an onerous performance obligation to be fulfilled at the beginning?



- b) How to account for a contract, profit-making at inception, including an onerous performance obligation to be fulfilled during the duration of the contract?



Many practical questions arise when determining whether this contract is onerous. IAS 37 does not exactly explain how to estimate the economic benefits expected from the contract. Nor does it provide any details as to how the costs to fulfil the contract should be determined.

69.1 Estimating the economic benefits expected to be received under the contract

On the first point, our view is that the constraint applicable to estimates of variable consideration (cf. **question 29**) when determining the contract transaction price should be ignored, consistently with the provisions of IFRS 15 on the estimate of the amount of consideration that an entity expects to receive used for the impairment testing of contract assets (cf. **question 66**).

The provisions of IAS 37, however, are not explicit regarding whether economic benefit estimates should be limited to the firm contract only, as defined by the contract identification criteria provided by IFRS 15 (cf. **question 10**), or whether unconfirmed elements can also be taken into account in the estimate (options, conditional tranches, specific contracts that are anticipated but not yet signed, etc.). In the absence of any clarification from the international standard-setter, a diversity of practices exists (it is prior to the effective date of IFRS 15). Where applicable, adapted disclosures should be provided to explain how an entity has applied IAS 37 to determine the expected economic benefits.

For example, in certain industries it is customary to sell equipment at low prices, as the profitability of the customer relationship is based on maintenance contracts and the supply of mandatory spare parts. In these cases, taking account of revenue from future contracts becomes a significant issue.

69.2 Determining the cost to fulfil

IAS 37 is not clear either on the second point, regarding what costs to include when determining the cost to fulfil a contract:

- only the incremental costs (i.e. the costs that would not have been incurred if the contract had not been obtained), thus excluding the proportional amortisation on assets assigned to the fulfilment of the contract,
- or all the costs to fulfil the contract, as previously required by IAS 11, *Construction contracts*?

The IFRS Interpretations Committee deliberated this question in 2017. A narrow-scope amendment to IAS 37 should be published in the coming months. Subject to the outcome of the IASB's due process, the IFRS IC position is that costs to fulfil correspond to those costs that relate directly to a contract, within the meaning of IFRS 15. These costs include, inter alia, an allocation of costs directly related to the contract or to contract activities, for example, the depreciation of tools and equipment used in fulfilling the contract.

70. How should whether an entity acts as a principal or as an agent be determined?

[\[IFRS 15.B34-B38\]](#)

In its application guidance, IFRS 15 includes detailed provisions for determining the nature of a performance obligation in the event that a third party acts to provide goods or services to a customer.



An entity may:

- act as principal: the nature of its promise is a performance obligation to provide the specified goods or services itself;
- act as agent: the nature of its promise consists of taking the necessary measures to enable the third party to do so.

The significance of this distinction is that it affects the presentation of the profit and loss account and the determination of the margin. This is because:

- when an entity acts as principal: the entity recognises revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or service transferred (as control of this good or service is transferred over time, or at the precise moment that control is transferred). The amount paid to the third party is accounted for in expenses;
- when an entity acts as an agent: the entity only recognises as revenue the proportion of the consideration which represents its remuneration, i.e. the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the third party. The revenue accounted for is therefore a net amount (the difference between the amount retained by the entity and the sum paid to the third party).



The provisions for the agent/principal distinction must be applied to each performance obligation separately, taking account of the breakdown of the contract at step 2 of the Standard (cf. **question 16**).

Hence, an entity will act as an agent (or principal) for all the goods and services grouped together in a single performance obligation forming a “bundle”. In other words, for a single performance obligation, an entity cannot be an agent for some of the activities and a principal for others.

However, if a contract includes more than one performance obligation, an entity could be a principal for some performance obligations and an agent for others.

To determine whether an entity is acting as a principal, it must determine whether it controls the specified good or service before that good or service is transferred to a customer. The agent/principal distinction thus explicitly depends on the concept of control defined in IFRS 15 (cf. **question 52**).

When an entity is a principal, it may obtain control of:

- a) a good or another asset from the other party that it then transfers to the customer (for example, the resale of computer equipment under some circumstances, alcohol distribution, etc.). An entity does not necessarily control a specified good if it obtains legal title to that good only briefly before legal title is transferred to a customer;
- b) a right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf (for example, when an entity directs a third party in the manner of performing a cleaning service). The Basis for Conclusions clarifies that the fact that the entity does not carry out the service itself is not determinative in the analysis (see IFRS 15.BC3850). However, it is often relevant to assess whether the right is created only when it is obtained by the customer, or whether the right to goods or services exists before the customer obtains the right. If the right does not exist before the customer obtains it, an entity would be unable to control that right before it is transferred to the customer (for example when a ticket for a show is not issued by an agency until it is purchased by the end customer);



- c) a good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer. Hence, an entity that acts as principal can itself fulfil a performance obligation consisting of providing the specified good or service, or employ a third party (for example, a subcontractor) to fulfil all or part of the performance obligation. IFRS 15 clarifies that in the - frequent - situations where an entity provides a significant service of integrating goods or services (cf. **question 20**) provided by another party into the specified good or service for which the customer has contracted, the entity controls the specified good or service before that good or service is transferred to the customer. This is because the entity first obtains control of the inputs to the specified good or service (which includes goods or services from other parties) and directs their use to create the combined output that is the specified good or service. For example, if an industrial entity subcontracts a significant part of an item of equipment (which does not constitute a distinct performance obligation) and obtains control of this part in order to integrate it into a larger whole for transfer to the customer, it is acting as a principal in respect of the whole (i.e. a single performance obligation consisting of transferring to the customer the integrated industrial good). This means that the revenue is recognised on a gross basis for the performance obligation as a whole (the sums invoiced by the subcontractor being presented in expenses).

Conversely, when the entity acts as an agent, it does not control the specified good or service supplied by a third party before this good or service is provided to the customer.

The Standard provides indicators for determining whether the entity controls the specified good or service before it is supplied to the customer. They include:

- a) the entity is primarily responsible for fulfilling the promise to provide the specified good or service. This typically includes responsibility for the acceptability of the specified good or service (for example, primary responsibility for the good or service meeting customer specifications);
- b) the entity has inventory risk before the specified good or service has been transferred to a customer or after transfer of control to the customer (for example, if the customer has a right of return). The inventory risk should not be understood as corresponding to the risk of loss. This is because, once an entity has physical possession of inventory, it must generally assume the storage risk, whether or not it controls the inventory. The inventory risk corresponds to the risk that the inventory will not be sold at an adequate price (or at all). This indicator applies to goods, but can also apply to services (for example, a travel agency buying air tickets from an aviation company to secure places on certain flights before receiving orders from potential customers);
- c) the entity has discretion in establishing the price for the specified good or service. However, an agent can have discretion in establishing prices in some cases. This indicator must therefore be analysed with caution.

Note that the credit risk is not included in the indicators proposed for making the agent/principal distinction (in contrast to the arrangements under IAS 18, which analysed exposure to the principal risks and rewards inherent in ownership of the underlying good or service).





In April 2016, IFRS 15 was amended to clarify the interaction between the general principle of transfer of control and the indicators above. These indicators are therefore only included to support an entity's assessment of control. They may be more or less relevant depending on the nature of the specified good or service, and the terms of the contract. The different indicators may provide more or less persuasive evidence, depending on the contracts.

The Basis for Conclusions of IFRS 15 clarifies that these indicators are not intended to override the general principle based on the transfer of control. Nor must they be viewed in isolation, the essential question being whether the entity controls the specified good or service before it is supplied to the end customer. Hence, these indicators do not constitute the basis for a separate evaluation to be conducted in every case. Nor must they be understood as a checklist of criteria to be met, or factors to be considered, in all scenarios (cf. IFRS 15.BC382 and IFRS 15.BC385H).

The agent/principal distinction may require the exercise of significant judgement, taking account of all the facts and circumstances, particularly when the asset that is the object of the transaction relates to the provision of a service (or a right to the provision of a service).

71. How should options for additional goods or services be accounted for?

[IFRS 15.B39-B43]

Contracts with customers often include options for additional goods or services. These options come in many forms: conditional tranches, apparently confirmed lots which the customer may decline to acquire by terminating the contract before the termination date, loyalty points enabling customers to obtain complementary goods, service contract renewal options, clauses for tacit renewal, etc.

The existence of options in these contracts, whether implicit or explicit, has a number of implications, depending on the step in the accounting model established by IFRS 15:

- they must be taken into account in the analysis at step 1 to determine the scope of the contract for the purposes of IFRS 15 (cf. **question 9**): the additional goods or services must be excluded if the customer is able not to acquire them (either by not taking up the option in the contract, or by early termination of the contract without having to pay a substantive penalty);
- consequently, the transaction price to be estimated at step 3 (cf. **question 26**) must only include the firm revenue, to the exclusion of the revenue from optional additional goods and services, whatever the likelihood that the option will be exercised. Estimating the transaction price also involves distinguishing between contracts including options (for example, a framework agreement for an undetermined number of manufactured parts from an auto parts maker) and contracts for which the quantities are likely to vary due to variable consideration (for example, a contract for outsourcing accounts payable processes for a fixed 5-year term with monthly invoicing depending on the quantity of invoices entered over the period). This distinction is not always easy to make and calls for judgement on the basis of the facts and circumstances. An entity must determine the nature of the promise and assess whether the entity has an obligation to transfer additional goods or services. The contract includes an option if this obligation only exists once the customer has exercised the option;
- IFRS 15 requires an entity to determine whether 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). This has a direct consequence for the identification of performance obligations carried out in step 2 (see below).



It may be difficult to assess whether the option to acquire additional goods or services provides a material right to the customer. IFRS 15 provides little guidance on this subject. In our view:

- the option provides a material right to the customer that it would not receive without entering into that contract if:
 - > the additional goods or services can be acquired for a much lower price than their stand-alone selling price (cf. **question 43**); or
 - > the discount is such that the margin expected on the goods and services in the option is significantly lower than for the goods and services in the firm part of the contract;
- the option does not provide a material right to the customer if:
 - > the price of the additional goods or services could reasonably be offered to other customers; or
 - > the margin expected on the option is consistent with the initial firm part of the contract, even if there is a reduction in the price of the additional goods or services (this reduction may be explained by the fact that the benefits of the learning curve are shared with the customer).

Nevertheless, the relevant facts and circumstances must be considered in each situation. Stable prices, including during the option periods, may provide a material right to the customer (for example, because the entity does not invoice again the upfront fee to be paid at inception, when the contract is renewed (cf. **question 24**).

In October 2014, the TRG (cf. **question 98**) clarified that evaluating the existence (or not) of a material right should include an assessment of both quantitative and qualitative factors (for example, assessing whether the customer could obtain substantially similar services from a competitor of the entity at an identical price).

The accounting for options for additional goods or services varies case by case:

- if the option provides a material right to the customer, a distinct performance obligation is identified (cf. **questions 16** and **22**) and a part of the revenue from the original contract is allocated to it. This is because IFRS 15 considers that, in this case, the customer in effect pays the entity in advance for future goods or services. An entity must therefore defer some revenue from the contract, recognising it when those optional goods or services are transferred (cf. **question 72**) or when the option expires (cf. **question 73**). In practice, an entity must (cf. example 13):
 - > determine the stand-alone selling price of the option, which must reflect the discount that the customer would obtain when exercising the option, adjusted for both of the following:
 - any discount that the customer could receive without exercising the option (i.e. the stand-alone selling price of the option only takes into account the incremental reduction to the customer concluding the initial contract);
 - the likelihood that the option will be exercised (i.e. the lower the likelihood that the customer will exercise the option, the lower the stand-alone selling price of the option will also be). An approach by portfolio of contracts may be applied where applicable (cf. **question 7**).
 - > allocate the contract revenue in proportion to the relative stand-alone selling prices of the goods and services promised in the contract, including the option (cf. **question 42**).
 - > recognise the revenue allocated to the option as a contract liability (cf. **questions 83**).
- if the option does not provide a material right to the customer, it is accounted for when it is exercised. In the absence of any clarification in IFRS 15, it seems possible to apply the Standard's provisions on contract modifications by analogy (cf. **question 15**).



IFRS 15 offers a practical expedient for renewal options (or similar) to avoid having to estimate the stand-alone selling price of these options when they provide a material right to the customer. Where the options relate to services (or goods) that are similar to the original services (or to the goods) provided in the initial contract, and where the prices of these additional services (or goods) are mentioned in the initial contract, IFRS 15 allows the transaction price to be allocated to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. This means having to estimate the likelihood that the option will be exercised. In practice, the total revenue expected in respect of the original contract and the option is allocated between all the services (goods) to be provided (i.e. whether firm or optional, provided that it is probable that they will be provided).

The March 2015 meeting of the TRG (cf. **question 98**) discussed the presence of a significant financing component (cf. **question 31**) in an option that provides a material right to the customer, given the advance payment received from him. The fact that IFRS 15 states that a contract with a customer does not contain a significant financing component if the customer has paid in advance for the goods or services and if the timing for providing these goods or services is at the customer's discretion (cf. **question 36**), was a major factor in its conclusion. Therefore, if the customer is free to decide when it will exercise the contract option, there is probably no significant financing component.

72. How should an entity account for a customer's exercise of an option with a material right?

IFRS 15 is not prescriptive as to the accounting treatment when a customer exercises an option with a material right for additional goods or services (for example, when a conditional tranche providing a material right to the customer is confirmed). As a reminder (cf. **question 71**), in such cases, a part of the transaction price was allocated at inception to this right, the option being treated as a distinct performance obligation.

The TRG meeting in March 2015 (cf. **question 98**) highlighted two possible accounting approaches:

- > one view consists of applying the IFRS 15 provisions for contract modifications (cf. **question 15**): the revenue deferred at inception is taken into account to determine the price of the contract modification;
- > the second view consists of assuming that the exercise of an option should be accounted for as a continuation of the contract, because that contract already contemplates the provision of additional goods or services. In practice, an entity should therefore account for the exercise of the option as a change in the transaction price (cf. **question 49**). The additional consideration (including the consideration deferred at inception and the additional price for the additional goods or services) should be allocated to the performance obligation underlying the additional goods or service at the date of the change.

As the option in the contract generally applies to goods or services that are distinct from the original goods or services transferred under the initial contract (cf. **question 18**), following the guidance on contract modifications would in this case lead to the same result as the view that this is a change of transaction price (i.e. prospective recognition). However, if the optional goods or services are determined to be not distinct (in particular in the event of application, by analogy, of IFRS 15 example 10 case B – cf. **question 21**), the accounting consequences of these two approaches would differ, since IFRS 15 requires a retrospective restatement where the contract modification rules are applied.

In its deliberations, the TRG (cf. **question 98**) indicated that this was not a matter of a choice of accounting principle, and that the application of one approach rather than another would depend on the facts and circumstances.

73. How should customers' unexercised rights be accounted for?

[IFRS 15.B44-B47]

Rights that are not exercised by customers (or unexercised/forfeited rights) can result from options to acquire additional goods or services at an favourable rate (cf. **question 71**), when these options are not ultimately exercised. They can also result from non-refundable prepayments by customers enabling them to acquire goods or of services at their discretion (for example, a gift card only partly used during its period of validity). In both cases, IFRS 15 requires an entity first to recognise a contract liability for its performance obligation to transfer, or to stand ready to transfer, goods or services in the future. That liability is derecognised (and revenue recognised) when the entity transfers those goods or services.

If customers do not exercise all the contractual rights arising from these non-refundable prepayments, it is then a matter of determining the pattern in which these amounts are recognised as revenue.

Two possibilities may be envisaged in practice:

- either an entity expects to be entitled to, and is able to determine, the minimum amount of breakage amount in a contract liability that is highly probable (taking account of the IFRS 15 requirements for constraining estimates of variable consideration, cf. **question 29**), in which case it must recognise the amount as revenue in proportion to the pattern of rights exercised by the customer. This accelerates the previously deferred recognition of revenue;
- or an entity does not expect to be entitled to a breakage amount, in which case it must recognise the expected amount as revenue when the likelihood of the customer exercising its remaining rights becomes remote.

An entity must revise its estimates at each reporting date and adjust as appropriate the amount for unexercised rights that is recognised as a contract liability (cf. **example 13**).

74. Does IFRS 15 include special provisions for customer loyalty programmes?

IFRS 15 contains no specific guidance for customer loyalty programmes. Nevertheless, the following provisions do apply directly to these programmes:

- the provisions for optional additional goods or services, a material right being provided to customers, given the nature of these programmes (cf. **question 71**);
- the provisions for customers' unexercised rights (cf. **question n 73**).

Note that the allocation principles set out at step 4 (cf. **question 42**) also apply to the allocation of the price to an option providing a material right (corresponding in effect to a distinct performance obligation). Hence, the residual approach cannot be applied freely (cf. **question 46**) to determine the part of the transaction price to be allocated to the option (in particular in the case of customer loyalty programmes, and in contrast to the previous approach authorised under IFRIC 13, which allowed the consideration allocated to gift points to be measured at fair value, regardless of the fair value of the other components of the initial sale).



Example 13

An entity has set up a customer loyalty programme whereby every euro spent is rewarded by one loyalty point.

Each loyalty point entitles the customer to a subsequent discount of 10 euro cents when the customer buys other products from the entity.

The loyalty points awarded to customers are valid for three years.

The entity applies a portfolio approach (cf. **question 7**), the customer contracts in question having similar characteristics.

Over the financial year, the entity's customers have spent €150k (corresponding to the stand-alone selling price of the cumulative sales) and have thus obtained 150k loyalty points.

The entity expects that 130k points will actually be used by these customers. The entity therefore estimates that the stand-alone selling price of the points that financial year is €13k.

At the beginning of the contract, the transaction price of €150k is allocated to the two performance obligations in the similar contracts:

- > products: $[(150\,000 / (150\,000 + 13\,000)) \times 150\,000] = €138\,037$
- > loyalty points: $[(13\,000 / (150\,000 + 13\,000)) \times 150\,000] = €11\,963$

When the products are sold, the revenue recognised is therefore €138 037, and €11 963 is accounted for as a contract liability (cf. **question 83**) as prepaid income.

At the end of the first financial year, 40k points have been used by customers and the entity still expects that 130k points will be used during the validity period. The entity accounts for the following additional revenue: $(40\,000 / 130\,000) \times €11\,963 = €3\,681$. A contract liability of €11 963 - €3 681, or €8 282 remains on the balance sheet.

At the end of the second financial year, 100k points have been used cumulatively by customers (meaning that 60k points have been used during this financial year). The entity revises its estimate of the number of loyalty points that will actually be used, and henceforth considers that there will be a total of 145k used during the validity period.

The additional revenue recognised for this financial year is:

$[100\,000 \text{ (points used to date)} / 145\,000 \text{ (points that will probably be used ultimately)} \times €11\,963] - €3\,681$ already accounted for in the first financial year, or €4 569.

The remaining revenue to be accounted for during the following financial year is €3 713 (or €11 963 - €3 681 - €4 569), whether the remaining 50k points still in circulation (including 45k which are expected to be actually used) are used or not, given the three-year validity period.



75. Licences: what is a “right to access” an entity’s intellectual property and how should this right be accounted for?

[IFRS 15.B56 & IFRS 15.B60]

IFRS 15 states that a right to access an entity’s intellectual property provides the customer with access to the entity’s intellectual property as it exists throughout the licence period. It must be accounted for as a performance obligation satisfied over time.

In practice, this type of licence corresponds to a service that the customer will simultaneously receive and consume as the performance occurs. The “right to access” the intellectual property therefore directly references the first criterion provided by IFRS 15 (cf. paragraph 35(a)) for determining that the transfer of control occurs over time – cf. **question 53**).

An entity must select an appropriate method to measure its progress towards complete satisfaction of that performance obligation to provide access by applying the Standard’s provisions (cf. **question 57**).

The phrase “dynamic licence” is sometimes used to express the evolving nature of this right.

IFRS 15 also clarifies the nature of a right to use an entity’s intellectual property (cf. **question 76**) and how to distinguish the two kinds of right identified in the Standard (cf. **question 77**).

76. Licences: what is a “right to use” an entity’s intellectual property and how should this right be accounted for?

[IFRS 15.B57 & IFRS 15.B61]

According to IFRS 15, a “right to use” an entity’s intellectual property provides the customer with a right to use the entity’s intellectual property as it exists at the point in time at which the licence is granted. This right must be accounted for as a performance obligation satisfied at a point in time.

The entity applies the general provisions of the Standard (cf. **question 61**) to determine the point in time at which control of the licence is transferred to the customer (i.e. the time from which the customer can decide to use the licence and obtain substantially all its remaining benefits). IFRS 15 observes that this date cannot be before the date at which the customer is able to use and benefit from the licence. For example, if a software licence period begins before an entity provides a code that enables the customer to use the software, the entity would not recognise revenue before that code has been made available.

IFRS 15 also clarifies the nature of a right to access an entity’s intellectual property (cf. **question 75**) and how to distinguish the two kinds of right identified in the Standard (cf. **question 77**).



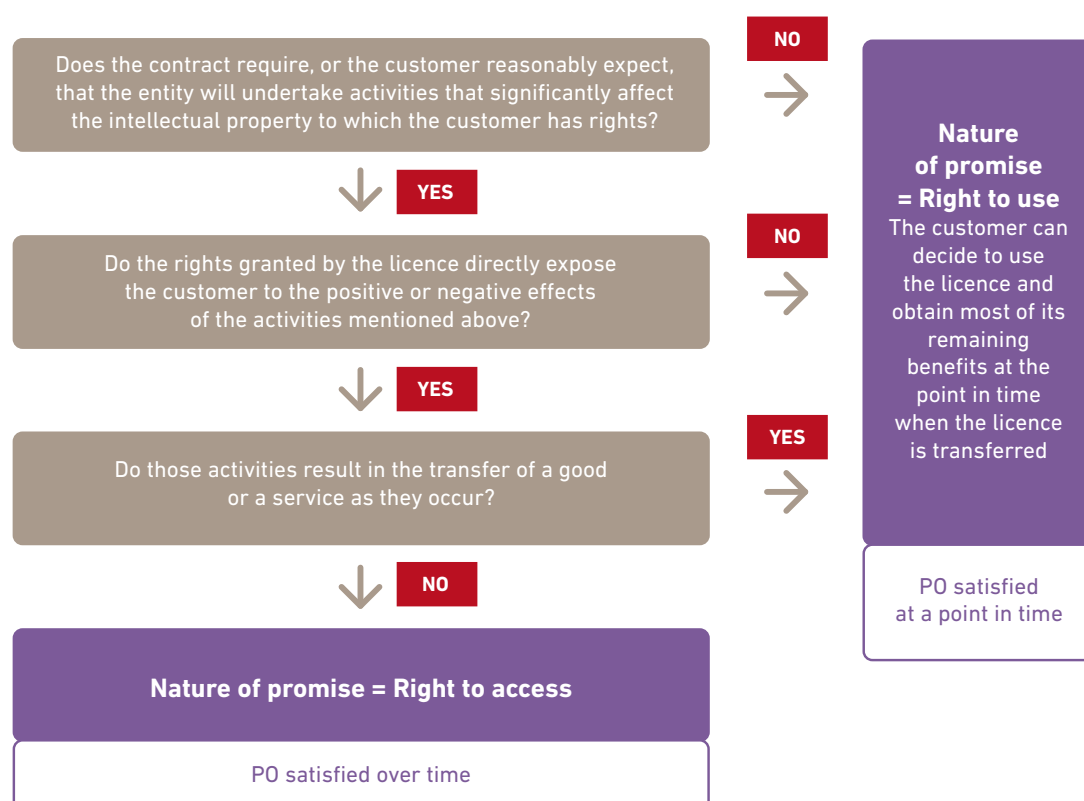
77. Licences: how can it be determined whether a licence confers a right to access or a right to use the intellectual property?

[IFRS 15.B58-B59A & IFRS 15.B62]

The Standard requires three cumulative conditions to be satisfied (see figure below) in order to conclude that a licence gives the customer a right to access the intellectual property (cf. **question 75**). If one of these conditions is not fulfilled, the licence is treated as a right to use the intellectual property (cf. **question 76**).

The analysis to be conducted in order to determine whether a licence grants a right to access intellectual property or the right to use it may call for the exercise of considerable judgement.

Figure 18



77.1 The first condition

The first condition considers whether the intellectual property to which the customer has rights is significantly impacted by the activities likely to be carried out by the entity throughout the period for which the rights are granted.

IFRS 15 clarifies that the entity's activities have a significant impact on the intellectual property in the following cases:

- those activities are expected to significantly change the form (for example, the design or content) or the functionality (for example, the ability to perform a function or task) of the intellectual property; or
- the ability of the customer to obtain benefit from the intellectual property is substantially derived from, or dependent upon, those activities. For example, the benefit from a brand is often derived from, or dependent upon, the entity's ongoing activities that support or maintain the value of the intellectual property.



To assess the impact of the entity's activities on intellectual property, it can be relevant to determine whether, at the time the licence is granted (and independently of the entity's future activities), it has an important functionality for the customer (the Standard uses the concept of a "significant stand-alone functionality" – and cites the following examples of intellectual property which often has such a functionality: software, biological compounds or drug formulas, and completed media content such as films, television shows and music recordings). If so, a substantial portion of the benefit of that intellectual property to the customer is derived from that functionality. The entity's future activities will have no significant impact on the customer's capacity to benefit from the intellectual property, unless they substantially change its form or functionality. In general, therefore, the right will be a right to use, and not a right to access.

The entity's activities during the period for which rights are granted may be defined by the contract or result from the customer's reasonable expectations.

According to IFRS 15, factors that may indicate that a customer could reasonably expect that an entity will undertake activities that significantly affect the intellectual property include the entity's customary business practices, published policies or specific statements. The existence of a shared economic interest (for example, a sales-based royalty) related to the intellectual property to which the customer has rights is another (not determinative) factor mentioned by the Standard.

Note that IFRS 15 does not converge with Topic 606 on this precise point (cf. **question 97**).

77.2 The third condition

As the analysis assumes that the licence constitutes a distinct performance obligation (or the main element of a distinct performance obligation – cf. **question 25**), it is necessary, consistently with the general principles of IFRS 15 relating to step 2 (cf. **question 18**), to exclude from this analysis any of the entity's activities that would result in the transfer to the customer of a distinct good or service. This is the objective of the third condition.



The relationship between the identification of distinct performance obligations in the contract and the analysis of the nature of a licence (right to access or right to use) may be rather complex (see the example below).

Care must be taken to watch out for potential interactions between these two steps.

Example 14

An entity enters into a contract with a customer for:

- > the grant of an intellectual property licence for the processes of design and manufacture of a good for a period of five years;
- > the supply, over the same period, of any updates developed by the entity.

The intellectual property that is the subject of the licence is used in an industry where technologies change rapidly, such that the benefit of the licence to the customer over five years without the expected updates would be significantly limited. The updates are therefore an integral part of the licence over the five-year period.

Thus, although the promises to provide the licence and the updates are distinct in absolute terms (as the customer can benefit from both promises independently of each other), they are not distinct "in the context of the contract" since they constitute inputs enabling the entity to satisfy the combined performance obligation of giving ongoing access to the entity's intellectual property over a five-year period.



This reasoning enables us to answer two questions concomitantly:

- > the identification of distinct performance obligations: in this instance, the contract contains only one performance obligation;
- > the nature of the performance obligation in terms of the specific guidance on licences: the performance obligation represents a right to access the intellectual property, which includes no significant stand-alone functionality immediately available to the customer from which it could benefit throughout the duration of the contract without the service associated with the update of the licence.

Note that the last conclusion is confirmed by the three conditions for a right-to-access type of licence (see the figure above) being met:

- > in this sector, the customer could reasonably expect that the entity will undertake activities that significantly affect the intellectual property;
- > the customer is directly exposed to any positive or negative effects of the entity's activities through the intellectual property rights it benefits from (since without these activities, the intellectual property would rapidly become obsolete);
- > the activities undertaken by the entity do not result in the transfer of distinct services (as analysed above).

77.3 Restrictions and guarantees

IFRS 15 states that, when determining the nature of a licence, an entity should disregard the following factors:

- restrictions of time, geographical region or use – those restrictions define the attributes of the promised licence, rather than define whether the entity satisfies its performance obligation at a point in time or over time.



In contrast, the Basis for Conclusion states that all contractual clauses, including restrictive clauses, are to be taken into account when identifying the performance obligations in a contract (cf. IFRS 15.BC414P). The Basis for Conclusions cites the example of a licence to use a musical recording in advertising for two different periods in two different countries (cf. IFRS 15.BC414Q). First, these restrictions are taken into account to determine if the contract includes one licence for the two countries, or two distinct licences, one for each; secondly, the nature of the promised licence(s) is analysed, without taking account of these restrictions, in order to determine whether they provide a right to access the intellectual property or a right to use it.

- guarantees provided by the entity that it has a valid patent to the intellectual property that is the subject of the contract, and that it will defend that patent from unauthorised use: a promise to defend a patent right is not a distinct performance obligation because the act of defending a patent protects the value of the entity's intellectual property assets and provides assurance to the customer that the licence transferred meets the specifications of the licence promised in the contract (consistently with the treatment of assurance-type warranties in IFRS 15 – cf. **question 23**).



78. Licences: how are sales-based or usage-based royalties accounted for?

[IFRS 15.B63-B63B]

Special provisions apply to sales of licences of intellectual property that are remunerated by variable consideration when this takes the form of a sales-based or usage-based royalty.

These provisions apply in the following cases:

- the royalty is allocated solely to the licence of intellectual property (either because the licence of intellectual property is the sole performance obligation in the contract, or because the fee is a variable consideration that is specifically allocated to it – cf. **question 48**);
- the royalty is allocated to a combined performance obligation (or several performance obligations) when a licence of intellectual property is the predominant item to which the royalty relates (a licence of intellectual property may be the predominant item when the entity has a reasonable expectation that the customer would ascribe significantly more value to the licence than to the other goods or services to which the royalty relates).

Under these circumstances, revenue from a sales-based or usage-based royalty shall be recognised when (or as) the later of the two following events occurs:

- the sale (or usage) on which the royalty is based occurs;
- the performance obligation to which the sales-based or usage-based royalty is allocated has been satisfied (or partially satisfied).

These provisions therefore represent a departure from the general rule in step 3 constraining the amount of variable consideration (cf. **question 29**), since they prohibit an entity from recognising revenue for a royalty before any uncertainty about the occurrence of the underlying condition (i.e. the sale or usage on which the calculation of the royalty depends) has been resolved.



The clarifications published in April 2016 indicate that, when a licence of intellectual property is the predominant item to which the royalty is allocated, but the royalty is also partly allocated to other goods and services, the specific constraint on sales-based or usage-based royalties applies to the whole revenue recognised for the royalty. It is not therefore permitted to apply this rule solely to the part of the royalty allocated to the licence of intellectual property and to apply the general constraint on variable consideration to the part of the royalty allocated to the other performance obligations in the contract.



Note that these provisions do not exempt an entity from conducting the analyses required at step 5, since resolving the uncertainty is not in itself a sufficient condition for recognising the revenue. In every case, therefore, it is necessary to determine when the performance obligation(s) to which the royalty is allocated is or are satisfied (cf. **questions 50-61** in the general case, and **questions 75-77** for the special case of licences of intellectual property).

It may be that, in practice, the two events underpinning the specific constraint for sales and usage-based royalties (i.e. the pace at which the performance obligation to which the royalty is allocated is satisfied, and the occurrence of the sale or usage on which the royalty is based) coincide. This is the case when:

- the royalty as a whole is allocated to a licence representing a right to access the intellectual property (i.e. a performance obligation satisfied over time);
- the consideration to which the entity is entitled as a royalty corresponds directly to the value of the service transferred to the customer (cf. **question 58**).

Example 15

An audio-visual producer holding the rights to a new televised series concludes a licence contract with a chain of stores authorising it to use the characters from the series for its promotional activities for a three-year period. New episodes will be broadcast during this period. The series includes a significant number of characters who change a lot during the course of the episodes. The contract contains reasonable constraints on the use of the characters, *inter alia* requiring their use to be consistent with the changes that they undergo during the series. In exchange for these rights, the producer receives a royalty based on the sales achieved by the chain of stores.

The contract contains only one performance obligation: the grant of the licence of intellectual property. The other activities carried out by the producer – the production of new episodes – do not transfer any distinct good or service to the customer (the customer only has a right to use the characters in the series for its promotional activities; it receives no right to the series episodes themselves). However, these activities do affect the intellectual property to which the customer has rights.

In light of the characteristics presented above, this licence represents a right to access the intellectual property, since:

- > the customer could reasonably expect that the entity will undertake activities (producing new episodes and developing the characters) that significantly affect the intellectual property;
- > the customer is directly exposed to any positive or negative effects of the entity's activities through the intellectual property rights it enjoys (the broadcasting by the entity of new episodes in the series could have positive or negative effects on the promotional campaign based on the series characters);
- > the activities undertaken by the entity (producing new episodes and developing the characters) do not result in the transfer of distinct services to the customer.

The entity observes that the consideration to which it is entitled through the royalty corresponds directly to the value of the service transferred to the customer. Recognition of the revenue on this basis therefore seems appropriate, in terms of both the principles governing the choice of measure of progress, and the specific constraint on sales or usage-based royalties.

In practice, the distinction between a right to access and a right to use a licence of intellectual property will not normally affect the pattern of revenue recognition where the entity's consideration is 100% variable and royalty-based, since the revenue will be *a priori* spread over the lifetime of the access to or use of the right, as the sale (or usage) on which the royalty is based occurs.



In November 2016, the TRG (cf. **question 98**) examined the case of sales-based or usage-based royalties with a minimum guaranteed amount, where these royalties fall within the scope of these provisions (i.e. the licence of intellectual property constitutes the sole or predominant performance obligation to which this “mixed” consideration is allocated).

This type of contract can take the following forms:

- the contract requires the supplier of the licence of intellectual property to receive consideration of 10% of sales to customers, or at least €1m;
- the contract requires the supplier of the licence of intellectual property to receive €1m and consideration of 10% of sales to customers in excess of €10m.

The question concerns the recognition pattern for this revenue.

If the licence of intellectual property represents a right to use (i.e. a performance obligation satisfied at a point in time), members of the TRG generally agreed that it was appropriate to recognise the minimum guaranteed amount at the time that control of the licence is transferred. Hence in this view the specific constraint on sales-based or usage-based royalties only applies to the additional amount (exceeding the minimum guaranteed amount) resulting from the customer’s sales or usage.

Where the licence of intellectual property represents right to access the intellectual property (i.e. a performance obligation satisfied over time), the analysis can be rather complex. This is because such a case creates a tension between two principles in IFRS 15:

- IFRS 15 requires the use of a single method of measuring progress towards satisfying a given performance obligation;
- the specific constraint on sales-based or usage-based royalties only applies to part of the consideration allocated to the performance obligation.

TRG members generally agreed that several approaches were possible, depending on the facts and circumstances, and that judgement was required to determine which method under the Standard best depicts its progress toward completion.

79. What is a repurchase agreement, and how should it be accounted for, depending on the nature of the agreement?

[IFRS 15.B64-B76]

To determine whether a customer obtains control of an asset, IFRS 15 states that any agreement to repurchase the asset should be taken into account (cf. **question 51**). This is because the economic consequences of a sale can be reversed, wholly or in part, by this type of agreement, and its effect on the transfer of control must therefore be understood.

IFRS 15 defines a repurchase agreement as 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, or another asset of which the asset that was originally sold is a component.



IFRS 15 distinguishes three forms of repurchase agreements:

- an entity has an obligation to repurchase the asset and the customer has an obligation to sell it (a forward);
- an entity has the right to repurchase the asset (a call option);
- an entity has an obligation to repurchase the asset at the customer's request (a put option held by the customer).

79.1 A forward or a call option

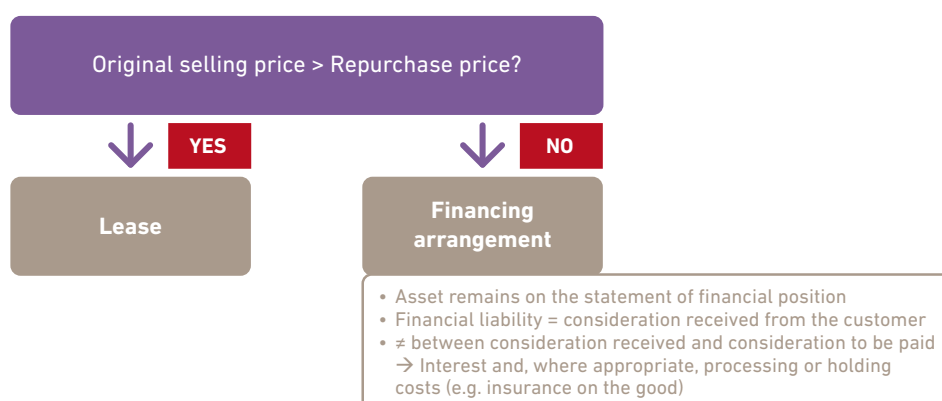
In the first two forms of repurchase agreement defined above, the customer undertakes to forward sell the asset to the entity (either irrevocably, in the case of a forward contract, or at the entity's request in the case of a call option).

In both cases, IFRS 15 states that the customer does not obtain control of the asset because it is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset (even if it has physical possession of the asset). In the case of a call option, it is not necessary to consider the probability of exercise to conclude that there is no transfer of control.

To determine the accounting treatment of these transactions, the original selling price and the repurchase price must be compared (taking account of the time value of money):

- if the original selling price is (strictly) higher than the repurchase price: the contract is essentially a lease and must be accounted for in accordance with IFRS 16, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with IFRS 9;
- otherwise, the transaction is analysed as a financing arrangement:
 - > the entity continues to recognise the asset and also recognises a financial liability for any consideration received from the customer (the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer is recognised as interest and, if applicable, as processing or holding costs – for example, insurance);
 - > if the option lapses unexercised, the liability is derecognised and revenue is recognised for the same amount.

Figure 19



79.2 Put option

In the case of a put option, it is the entity that has an obligation to repurchase the asset at the customer's request. If the customer has no significant economic incentive to exercise the option, this transaction does not differ from a sale with right of return, and is therefore accounted for according to the IFRS 15 provisions applicable to this type of sale (cf. **question 31**).

The Basis for Conclusions clarifies that this means the recognition of the following items when the asset is transferred (cf. IFRS 15.BC428):

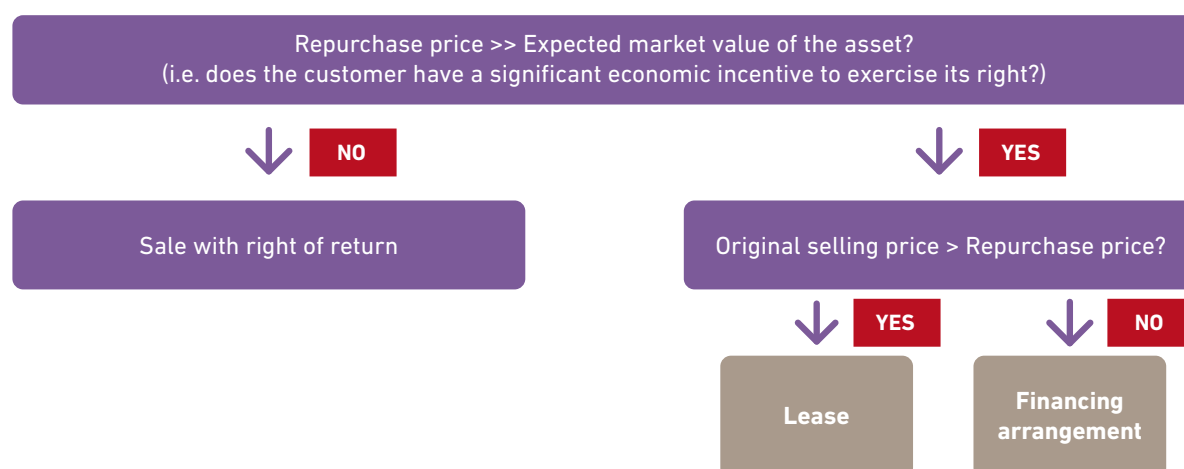
- a liability for its obligation to repurchase the asset, measured at the amount of the consideration expected to be paid to the customer;
- an asset for the entity's right to receive that asset upon settling that liability, measured at an amount that may or may not equal the entity's previous carrying value of the asset; and
- revenue on transfer of the asset for the difference between the selling price of the asset and the liability recognised for the obligation to repurchase the asset.

However, if the customer has a significant economic incentive to exercise the option, the analysis is similar to that carried out in the case of a forward contract and a call option:

- if the original selling price is (strictly) higher than the repurchase price: the contract is essentially a lease and must be accounted for in accordance with IFRS 16, unless the contract is part of a sale and leaseback transaction. If the contract is part of a sale and leaseback transaction, the entity shall continue to recognise the asset and shall recognise a financial liability for any consideration received from the customer. The entity shall account for the financial liability in accordance with IFRS 9;
- otherwise, the transaction is analysed as a financing arrangement (and accounted for as described in **question 79.1** above).

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 the repurchase and the amount of time remaining until the right expires. For example, if the repurchase price is expected to significantly exceed the market value of the asset, this may indicate that the customer has a significant economic incentive to exercise the put option.

Figure 20



80. How should a consignment arrangement be accounted for?

[IFRS 15.B77-B78]

IFRS 15 indicates that when an entity delivers a product to another party (such as a dealer or a distributor) for sale to end customers, it should evaluate whether that other party has obtained control of the product at that point in time. If the third party, acting as an intermediary between the entity and the end customer, has not obtained control of the product at the time of delivery, this constitutes a “consignment arrangement” in IFRS 15.

IFRS 15 provides a (non-exhaustive) list of indicators suggesting that an arrangement is a consignment arrangement:

- the product 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;
- the entity is able to require the return of the product or transfer the product to a third party (such as another dealer); and
- the dealer does not have an unconditional obligation to pay for the product (although it might be required to pay a deposit).

No revenue is recognised upon delivery of a product to an intermediary if the delivered product is held on consignment. This must wait until it is subsequently delivered by the intermediary to the entity's end customer – consistently with the general principle of the Standard (cf. **question 5**).

Note that IFRS 15 does not explicitly link the provisions for consignment arrangements and the agent/principal distinction (cf. **question 70**). In our view, in the case where an agreement between an entity and an intermediary (such as a dealer or a distributor) is a consignment arrangement in which the entity retains control of the good until it is sold to the end customer, the intermediary is an agent of the entity.



81. How should a bill-and-hold arrangement be analysed?

[IFRS 15.B79-B82]

IFRS 15 defines a “bill-and-hold arrangement” as 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 later date. The customer may obtain control of the good when it is delivered to the customer or earlier, even while the entity still has physical possession of the product.

To determine when control is transferred, IFRS 15 sets out the following approach:

- examine the general criteria for analysing the transfer of control at a point in time (cf. **question 61**);
- examine a series of indicators specific to the case of bill-and-hold arrangements, which – unlike the set of indicators first analysed as mentioned above – must all be present to conclude that a customer has obtained control of a product before delivery:
 - > the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
 - > the product must be identified separately as belonging to the customer;
 - > the product must be ready for physical transfer to the customer; and
 - > the entity does not have the ability to use the product or to direct it to another customer.

If transfer of control takes place before delivery, an entity must consider whether it has remaining performance obligations (for example, for custodial or delivery services) to which it should allocate a portion of the transaction price.



PRESENTATION OF THE STATEMENT OF FINANCIAL POSITION

[QUESTIONS 82 TO 84]



82. What is a contract asset and how should it subsequently be measured?

[IFRS 15.105, IFRS 15.107 & IFRS 15.109]

If one or other party to a contract has fulfilled its obligations, the entity shall present the contract on the statement of financial position as a contract asset or a contract liability (cf. **question 83**), depending on the relationship between the entity's performance and the payment made by the customer.

In practice, a contract asset is therefore presented on the statement of financial position when the entity has "performed" more of its respective obligations than the customer (i.e. transferring the good or service for the entity, transferring the promised consideration for the customer). If the contract contains several performance obligations, the analysis is carried out on an aggregated basis at contract level (cf. **question 16**). The entity must present a net contract asset, where applicable.

IFRS 15 also defines a contract asset as an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer, when that right depends on something other than the passage of time (for example, the future performance of the entity). This clarification serves to distinguish a contract asset from a receivable (cf. **question 84**). An entity must present its receivables separately from contract assets.

The costs to obtain a contract (cf. **question 62**) and the costs to fulfil a contract (cf. **question 64**) that have been capitalised must also be presented separately from contract assets.



When a performance obligation is satisfied, but all the amounts due from the customer have not yet been invoiced by the entity, the question arises of whether the asset accounted for (i.e. an unbilled receivable) is a contract asset or a receivable.

According to the Basis for Conclusions of the Standard, if the invoicing is simply an administrative task, and there is no reason to consider that the entity does not have an unconditional right to that consideration (i.e. only the passage of time is required before payment of that consideration is due), an unbilled amount is a receivable (cf. IFRS 15.BC325).

By way of example, a contract asset is recognised under the following circumstances:

- in a contract for the sale of a telephone and a subscription, the allocation of the revenue in proportion to the relative stand-alone selling price (cf. **question 42**) results in allocating to the telephone a sum higher than the amount received at the time of the sale of the telephone (in the common case where the purchase of the telephone by the customer has been "subsidised" by the telecommunications operator). The difference between these two amounts constitutes a contract asset since the entity has no right to invoice and receive this difference except over the course of performance of the telephone subscription services;
- in a long-term construction contract for which the revenue is recognised over time, the revenue recognised minus interim invoices is also a contract asset since the entity's unconditional right to consideration depends on its performance until the construction is completed;
- when the consideration in a contract is variable (cf. **question 28**), the amount of revenue recognised before the uncertainty is resolved constitutes a contract asset as the entity's right to consideration depends on something other than the passage of time.



The term “contract asset” is not mandatory, and an entity can decide to use an alternative label. In this case, it must provide sufficient disclosures so that users of financial statements can distinguish between receivables and contract assets.

IFRS 15 does not require a separate presentation of this item on the statement of financial position. The general principles of IAS 1 apply, meaning that an entity must present this item separately when that presentation is relevant to an understanding of its financial situation.

Specific disclosures on the balances of contract assets are required (cf. **question 86**).

Finally, a contract asset must be tested for impairment in accordance with IFRS 9. The impairment of a contract asset must be measured, presented and communicated in the same way as a financial asset under IFRS 9, but the information must be presented separately from the impairment arising from other contracts (i.e. contracts that are not with customers).

83. What is a contract liability?

[IFRS 15.105-106 & IFRS 15.109]

If one or other party to a contract has fulfilled its obligations, the entity shall present the contract on the statement of financial position as a contract asset (cf. **question 82**) or a contract liability, depending on the relationship between the entity’s performance and the payment made by the customer.

In practice, a contract liability is therefore presented on the statement of financial position when the customer has “performed” more of its respective obligations than the entity (i.e. transferring the promised consideration for the customer, transferring the good or service for the entity). If the contract contains several performance obligations, the analysis is carried out on an aggregated basis at contract level (cf. **question 16**). The entity must present a net contract liability, where applicable.

IFRS 15 defines a contract liability as an entity’s obligation to transfer to a customer goods or services for which the entity has received consideration (or for which an amount of consideration is due) from the customer.

In practice, contract liabilities therefore include advance payments and deposits received from the customer and deferred revenue.



An advance payment is recognised on the statement of financial position when the first of the following two events occurs:

- it is due and the contract cannot be terminated, or
- the cash has been received.

In the first case, the contract liability is recognised against a corresponding receivable, since the entity has an unconditional right to be paid.

In contrast, provisions for an onerous contract (cf. **question 69**) are presented separately.

The term “contract liability” is not mandatory and an entity can decide to use an alternative label (in which case it may be necessary to indicate the terminology used in the notes).

IFRS 15 does not require a separate presentation of this item on the statement of financial position. The general principles of IAS 1 apply, meaning that an entity must present this item separately when that presentation is relevant to an understanding of its financial situation.

Specific disclosures on the balances of contract liabilities are required (cf. **question 86**).

84. What is a receivable and how should it subsequently be accounted for?

[IFRS 15.108]

A receivable is an entity’s right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due.

For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity also recognises a receivable when it concludes a contract that cannot be terminated and a payment is due from the customer before the entity transfers the promised goods or services. In this instance, a receivable is recognised against a contract liability (cf. **question 83**).

In practice, it is not always easy to distinguish between a receivable and a contract asset, in particular in the case of unbilled revenue (cf. **question 82**).

An entity must recognise a receivable in accordance with IFRS 9. At initial recognition of a receivable related to a contract with a customer, any difference between the value of the receivable under IFRS 9 and the amount corresponding to the revenue accounted for must be expensed (for example, as an impairment loss).

Specific disclosures on the balances of receivables are required (cf. **question 86**).



DISCLOSURES IN THE NOTES TO THE FINANCIAL STATEMENTS

[QUESTIONS 85 TO 89]



85. What are the cross-cutting issues in the preparation of the notes to the annual financial statements?

[IFRS 15.110-112]

85.1 Consider the objective of the disclosure requirements

In IFRS 15, consistently with other Standards, the disclosure requirements rely on a primary objective, accompanied by a list of the minimum information to be presented (subject to materiality).

This primary objective is to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue from ordinary activities and the cash flows arising from contracts with customers.

The objective concerns not only the revenue recognised, but also its translation in terms of cash flows. Explaining the timing differences between revenue accounted for and the corresponding cash flows – in other words, the impacts on balances (for which the minimum disclosure requirements have been strengthened by comparison with previous revenue recognition Standards) – is also a significant issue.

To assess whether the disclosures are sufficient and relevant, an entity should consider this objective and provide additional information not listed in the Standard if necessary (that is, entities must avoid a “check-list” approach).

For example, additional disclosures may be needed in the event of significant in kind consideration (cf. **question 39**).

85.2 Significant judgements in the application of the Standard

The Standard-setters are fully aware of the importance of the exercise of judgement in applying IFRS 15, and have provided guidance to help preparers in their election of disclosures concerning significant judgements.

Beyond the general requirements for disclosures on the exercise of judgement (cf. IAS 1.122 and 125), specific disclosure requirements on this matter are listed by the Standard, relating to:

- measurement (cf. **questions 26-40**) and pattern of revenue recognition (cf. **questions 50-61**);
- recognition and amortisation of assets recognised in respect of the costs to obtain or costs to fulfil contracts with customers (cf. **questions 62-68**).

85.3 Organise the information in a relevant way

As with other IFRSs, a certain leeway is left to the entity in the organisation and content of its notes to the financial statements.

IFRS 15 nevertheless states that disclosures should present a relevant level of aggregation or disaggregation. This enables an entity to avoid providing useless information, which would make useful information harder to locate. This would also prevent the entity from grouping together matters with substantially different characteristics.



In our view, a degree of consistency should also be sought across the disclosures in the notes to the financial statements provided under IFRS 15. For example, if it is relevant to distinguish several categories when presenting an entity's revenue sources (qualitative information on performance obligations – cf. **question 86**), it seems relevant to disaggregate the revenue presented (quantitative information) into at least some of these categories.

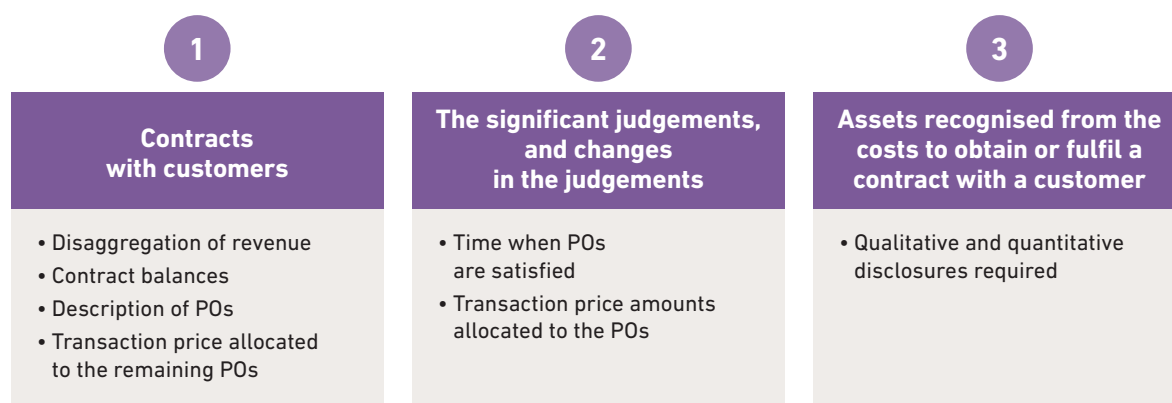
IFRS 15 explicitly states that an entity need not disclose theoretically required information if it has provided the information elsewhere in accordance with another Standard. An entity may therefore take any opportunity to cross-reference the disclosures in respect of other Standards in order to reduce the volume of its notes.

86. What detailed disclosures should be provided in the notes?

[IFRS 15.113-129]

IFRS 15 disclosure requirements fall into three categories.

Figure 21



The requirements of the Standard for each of these categories are detailed in the following table:

	Information type	Main disclosures	Comments
1	Disaggregation of revenue	cf. question 87	
	Contract balances, i.e. receivables, contract assets and contract liabilities (cf. questions 82-84)	— The effects arising from the relationship between the timing of satisfaction of the entity's PO and the typical timing of payment on the contract asset and contract liability balances	This obligation aims to explain the link between revenue recognised by the entity and the related payments it receives, satisfying the requirements of the Standard's objective (cf. question 85).
		— Opening and closing balances	
		— Revenue recognised in the reporting period: • Included in the contract liability balance at the beginning of the period • Relating to POs satisfied (or partially satisfied) in previous periods	Information about revenue relating to POs satisfied in previous periods (catch-up adjustments) can be difficult to capture through information systems and requires some adaptation of systems and processes.
		— Qualitative and quantitative disclosures explaining significant changes in the balances	The Standard provides a non-exhaustive list of changes that should be mentioned (changes due to business combinations, cumulative catch-up adjustments, impairment of a contract asset, etc.). Depending on the circumstances, other causes of significant changes may also be relevant. The information does not necessarily have to be presented in the form of a table.
Description of POs (cf. question 16)	— Nature of the promised goods or services — Significant payment terms (when payment is typically due, whether the contract has a significant financing component, whether the consideration amount is variable, etc.) — Guarantees and associated obligations where applicable	This information can prove particularly useful in understanding an entity's activity (since it effectively describes its sources of revenue).	
	Transaction price allocated to the remaining POs	cf. question 88	
2	Timing of satisfaction of POs (cf. questions 52, 57 and 61)	— <u>For POs satisfied at a point in time</u>: significant judgements made to assess when a customer obtains control of the promised goods or services — <u>For POs satisfied over time</u>: the methods used for measuring progress and justification of their appropriateness	This information is particularly useful and important for understanding the judgements exercised in respect of a major aspect of the application of IFRS 15.
	Transaction price and amounts allocated to the POs (cf. question 42)	— Elements making up the transaction price, estimates of variable consideration (methods, inputs, assumptions) and constraints where applicable — Allocation of the transaction price, including allocation of variable consideration / discounts where applicable to a specific part of the contract	An entity shall explain in the notes whether it is applying the practical expedient relative to the existence of a significant financing component (cf. question 33).
3	Assets recognised for the costs to obtain or fulfil a contract (cf. questions 62-66)	— Qualitative disclosures: • Judgements exercised in determining the amount of the costs incurred to obtain or fulfil a contract • Method used for the amortisation of the underlying assets — Quantitative disclosures: • Closing balances of assets by main category • Amount of amortisation and any impairment losses recognised in the reporting period	An entity shall explain in the notes whether it is applying the practical expedient for the incremental costs to obtain a contract (cf. question 64). As a reminder, the impairment losses on receivables and contract assets are recognised in accordance with IFRS 9 (cf. questions 82 and 84), while impairment losses on assets recognised for costs to obtain or fulfil a contract fall within the scope of IFRS 15 (cf. question 66).





In accordance with IAS 1, relevant information should also be provided about the accounting principles applied and the choices made by the entity when applying IFRS 15 (in particular, as regards presentation of the primary financial statements), in particular:

- The decision to elect terms used in the Standard to characterise certain elements or to choose others (for example, “contract asset” and “contract liability”);
- The decision to present or not certain items (contract assets, contract liabilities, costs to obtain a contract, costs to fulfil a contract, liabilities for future repayments, right to recover a returned product) on a separate line, subject to their materiality (as required by IAS 1);
- The classification adopted for some items not presented on a separate line either on the statement of financial position or in profit or loss.

87. How should revenue be disaggregated?

[IFRS 15.114-115 & IFRS 15.B87-89]

An entity shall disaggregate revenue recognised from contracts with customers into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

Beyond this objective, IFRS 15 provides the following indications in its application guidance:

- the extent of disaggregation depends on the facts and circumstances of the contracts the entity has concluded with its customers. Hence some entities may need to use more than one type of category (for example, showing disaggregation in a matrix format covering several headings) to meet the previously mentioned objective, while other entities may meet the objective by using only one type of category;
- in its choice, an entity must take into account the way in which disclosures on revenue have been presented for other purposes, whether the information regularly examined by the chief operating decision maker in order to assess the financial performance of operating segments (under IFRS 8) or the information presented outside the financial statements, such as in earnings releases, annual reports or investor presentations.

IFRS 15 gives the following examples of categories that might be appropriate:

- a) type of good or service (for example, major product lines);
- b) geographical region (for example, country or region),
- c) market or type of customer (for example, government and non-government customers, professional customers and private individuals);
- 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) date or 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); and
- g) sales channels (for example, goods sold directly to consumers and goods sold through intermediaries).



In addition, an entity shall provide sufficient information to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment (in accordance with IFRS 8).



In some cases, IFRS 15 does not exclude the possibility that disaggregation of revenue in application of IFRS 8 (i.e. by operating segment, by product or service and by geographical area) will be sufficient to meet the requirements of IFRS 15. This assumes in particular that such information is not based on "non-GAAP" information, as allowed under IFRS 8.

The Basis for Conclusions nonetheless highlight the fact that the objective of revenue disaggregation in IFRS 8 (i.e. to provide information on the nature and financial effects of the entity's activities) is different from the objective of revenue disaggregation in IFRS 15 (see objective above). For example, difficulty in measuring the revenue from a particular category of contracts with customers may mean that disaggregation at a more granular level is necessary for the purposes of IFRS 15 (cf. IFRS 15.BC340).

88. What disclosures should be provided for performance obligations that are not yet (or only partially) satisfied?

[IFRS 15.120-122]

IFRS 15 requires the following disclosures for performance obligations that are not yet (or only partially) satisfied (resembling the concept of the "backlog"):

- the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period (cf. **question 88.1**);
- an explanation of when the entity expects to recognise this amount as revenue, 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 (cf. **question 88.2**).

As a practical expedient, an entity need not disclose that information if:

- the performance obligation is part of a contract that has an original expected duration of one year or less; or
- the entity applies the practical expedient consisting of measuring its revenue in the amount to which the entity has a right to invoice (cf. **question 58**).

In this case, the entity must mention the use of this practical expedient in the notes to its financial statements.





- The exercise of judgement when applying IFRS 15 can have an immediate and significant impact on the “backlog”. If this is the case, these significant judgements must be mentioned in the notes, including: the time at which a contract satisfies the identification criteria (cf. **question 10**), the distinction between variable consideration (cf. **question 28**) and an option (cf. **question 71**), the application of the constraint on variable consideration (cf. **question 29**), the agent/principal analysis (cf. **question 70**), etc.
- In some industries, the disclosure of an indicator in the notes close to the “backlog” concept, given a standardised accounting treatment by IFRS 15, may introduce significant variations by comparison with the management indicator used elsewhere in an “economic” approach of the “backlog” (for example, because of the inclusion of options). In our view, the continued reporting of a “non-GAAP” aggregate outside the financial statements requires clear definition and different terminology from that used in the notes in application of IFRS 15. A reconciliation with the disclosures required by IFRS 15 also seems relevant.

88.1 How should the amount of the transaction price allocated to performance obligations that are unsatisfied (or partially unsatisfied) be determined?

Firstly, preparers should ensure that the contracts in the “backlog” satisfy the identification criteria set out at step 1 of the standard (cf. **question 10**). Contracts that are wholly unperformed should only be included if they create enforceable rights and obligations for both parties (cf. **question 9**).

When determining the amounts to include, preparers should then:

- apply the constraint on variable considerations (cf. **questions 28** and **29**);
- exclude unexercised options (cf. **question 71**).

An entity shall explain qualitatively in the notes whether any consideration from contracts with customers is excluded from the transaction price and therefore is not included in the “backlog” provided under IFRS 15 (for example, in application of the rule of constraining variable consideration).

88.2 When an entity disclose explanation of when it expects to recognise as revenue the amount disclosed in the “backlog” on a quantitative basis, how are the appropriate “time bands” identified?

In the absence of any prescriptive requirements on this matter, our view is that entities should primarily seek to ensure the relevance of the “time bands” used in terms of the particular features of their contracts with customers.



89. What disclosures should be provided in the notes to the condensed interim financial statements?

The overall principle of IAS 34 – *Interim Financial Reporting* is that an entity must explain in its interim report the events and transactions that are significant to an understanding of any changes in its financial position and performance since the end of the last annual reporting period. This principle applies, among others, to contracts with customers.

In addition, IAS 34 requires at least the following disclosures:

- a disaggregation of the entity's revenue in application of IFRS 15 (cf. **question 87**);
- information on impairment losses on assets arising from contracts with customers.

Disclosures about the "backlog" (cf. **question 88**) are not required in the IFRS condensed interim financial statements (unlike US GAAP). Nonetheless, such information should be provided if the "backlog" is impacted over the period by a significant change, and if this information is important in respect of the entity's activities (for example, cancellation by a customer of a major order for which the entity had reported in detail when obtained due to its strategic importance for its business).



TRANSITION TO IFRS 15

[QUESTIONS 90 TO 95]



90. What is the effective date of IFRS 15?

[\[IFRS 15.C1-C1C\]](#)

IFRS 15 is applicable to financial periods beginning as of 1 January 2018. Early application was authorised.

The European Union endorsed the original version of IFRS 15 at the end of 2016, and the IASB's clarifications in November 2017.

In practice, IFRS 15 must be applied to the first IFRS accounts published in the year of first application (i.e. the quarterly or half-yearly accounts, whether or not they are condensed under IAS 34).

91. What are the transitional arrangements for IFRS 15?

[\[IFRS 15.C3 & IFRS 15.C7-C8A\]](#)

IFRS 15 offers entities a choice of two approaches to the transition:

- the **full retrospective method**, which consists of applying IFRS 15 retrospectively, in accordance with IAS 8 on changes of accounting policies. The impacts of the change of standard are therefore accounted for in the opening equity for the earliest period presented (in most cases, 1 January 2017). The comparative periods presented (2017 or even 2016) must be restated; or
- a **modified retrospective method**, which consists of recognising the retrospective impacts of the change of accounting policy in the opening equity for the first period of application (i.e. 1 January 2018 in most cases). In practice, the comparative periods presented are not restated, and are therefore presented in accordance with IAS 11, IAS 18 and the associated Interpretations in force before the change. Under this approach, an entity may elect to apply IFRS 15 retrospectively only to contracts that are not completed at the date of first application (cf. **question 93**).

In both cases, practical expedients are offered to preparers in order to facilitate the transition (cf. **question 92**). These expedients are more numerous in the case of the full retrospective method.

Each method has its own advantages and drawbacks. These should be assessed in the light of an entity's particular circumstances in order to choose the most relevant method (cf. **question 95**).



Example 16: restatements to be recognised at the transition date for a long-term contract on which revenue is accounted for over time

Case 1: the percentage of completion under IFRS 15 is higher than under IAS 11

- Contract price: 1,000
- Margin: 200

	% cumulative progress	IAS 11(*) 50% IFRS 15(**) 52.5%	IAS 11(*) 60% IFRS 15(**) 61.5%	IAS 11(*) 71% IFRS 15(**) 71.5%
IAS 11 / IAS 18	Previous periods (cumulative)	2017	2018	
Backlog	500	400	290	
Revenue	500	100	110	
Full retrospective method (IFRS 15)	Previous periods (cumulative at 01/01/17 – not republished)	2017 (restated)	2018 (1st period of application)	
Backlog adjustment at 01/01/17	-25	← "Lost" revenue (margin: 5)		
Backlog	475	385	285	
Equity adjustment at 01/01/17	5			
Revenue	525	90	100	
Modified retrospective method (IFRS 15)	Previous periods (cumulative – not republished)	2017 (not restated)	2018 (1st period of application)	
Backlog adjustment at 01/01/18			-15	
Backlog book	500	400	285	
Equity adjustment at 01/01/18			3	← "Lost" revenue (margin: 3)
Revenue	500	100	100	

(*) percentage of completion determined using the technical milestones method

(**) percentage of completion determined using the cost-to-cost method



Case 2: the percentage of completion under IFRS 15 is lower than under IAS 11

- Contract price: 1,000
- Margin: 200

% cumulative progress

IAS 11(*): 50%
IFRS 15(**): 47.5%

IAS 11(*): 60%
IFRS 15(**): 56.5%

IAS 11(*): 71%
IFRS 15(**): 66.5%

IAS 11 / IAS 18	Previous periods (cumulative)	2017	2018
Backlog	500	400	290
Revenue	500	100	110
Full retrospective method (IFRS 15)	Previous periods (cumulative at 01/01/17 – not republished)	2017 (restated)	2018 (1 st period of application)
Backlog adjustment at 01/01/17	25	← Revenue "double-counted" (margin 5)	
Backlog	525	435	335
Equity adjustment at 01/01/17	-5		
Revenue	475	90	100
Modified retrospective method (IFRS 15)	Previous periods (cumulative – not republished)	2017 (not restated)	2018 (1 st period of application)
Backlog adjustment at 01/01/18		35	← Revenue "double-counted" (margin 7)
Backlog book	500	400	335
Equity adjustment at 01/01/18		-7	
Revenue	500	100	100

*) percentage of completion determined using the technical milestones method

**) percentage of completion determined using the cost-to-cost method

92. What are the practical expedients offered for each transition method?

[IFRS 15.C5 & IFRS 15.C7A]

IFRS 15 allows first-time adopters of IFRS 15 to use practical expedients to facilitate the transition.

Whichever transition method chosen, an entity can use these practical expedients under the following conditions:

- each expedient used must be applied consistently to all contracts within the scope of IFRS 15, for all the reporting periods presented;
- the following information must be disclosed:
 - > the expedients that have been used; and
 - > to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.



92.1 Full retrospective method

The practical expedients provided by IFRS 15 to simplify the retrospective restatements that must be carried out in application of IAS 8 are:

- for completed contracts (cf. **question 93**), an entity need not restate:
 - > contracts that began and ended within the same annual reporting period (generally, 2017). If the entity does not use this expedient, the interim periods presented must be restated, including these specific contracts, in order to comply with IFRS 15;
 - > completed contracts at the beginning of the earliest period presented (generally, 1 January 2017).
- for completed contracts 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 presented;
- an entity need not retrospectively restate contracts that were modified before the beginning of the earliest period presented:
 - > in practice, the practical expedient means that an entity will be able to present the aggregate effect of these modifications at the start of the first comparative period presented:
 - identifying the satisfied and unsatisfied performance obligations;
 - determining the transaction price; and
 - allocating the transaction price to the satisfied and unsatisfied performance obligations.
 - > if this expedient is not used, an entity must restate these contracts from inception, accounting for each successive modification.
- for all the reporting periods presented before the date of initial application (i.e. generally 1 January 2018), an entity need not disclose the amount of the transaction price allocated to the remaining performance obligations (a concept equivalent to the “backlog”, cf. **question 88**), nor provide an explanation of when the entity expects to recognise that amount as revenue.

92.2 Modified retrospective method

The practical expedients provided by IFRS 15 if this alternative transition method is chosen are:

- to apply IFRS 15 retrospectively only to contracts that are not completed contracts (cf. **question 93**) at the date of initial application (generally 1 January 2018);
- to apply the practical expedient provided for use under the full retrospective method in the event of contract modifications (cf. **question 92.1**):
 - > to all contract modifications that occurred before the beginning of the earliest period presented (generally 1 January 2017); or
 - > to all contract modifications that occurred before the date of initial application (generally 1 January 2018).

93. What is a “completed” contract?

[IFRS 15.C2]

IFRS 15 defines a completed contract as a contract for which the entity has transferred all of the goods or services identified in accordance with IAS 11, *Construction Contracts*, IAS 18, *Revenue* and the related Interpretations.

In July 2015 the TRG (cf. **question 98**) was asked a question aiming to clarify this concept. At its September 2015 meeting, the IASB decided not to amend the definition of a completed contract as given in the original Standard. However, the FASB decided to amend the definition of a completed contract to indicate that this is a contract for which all or almost all the revenue has been accounted for in accordance with the previous Standards on revenue recognition. Therefore, there is no longer convergence between IFRS 15 and Topic 606 on this point.

Under IFRS 15, and according to the staff analysis, the concept of “transfer” relates to the delivery of goods (or the rendering of services) under IAS 18. Therefore, a contract is completed if, under the previous Standard, an entity has delivered all the goods or rendered all the services identified under this same Standard, even if part of the revenue has not yet been recognised for reasons such as uncertainties as to collectability, or the existence of variable consideration. After the first application of IFRS 15, any still-unrecognised revenue for completed contracts must be accounted for in accordance with the previous Standards where these contracts are not restated under IFRS 15 in application of the practical expedient (cf. **question 92**).

94. What disclosures should be provided in the notes at the transition date?

[IFRS 15.C4, IFRS 15.C6 & IFRS 15.C8]

The disclosures to be provided in the first annual accounts drawn up under IFRS 15 depend on the transitional arrangements used (cf. **question 91**):

— **full retrospective method:**

- > an entity applying this method must comply with IAS 8.28 on disclosures in the event of first application of a new IFRS and thus give: the title of the new Standard (in this case, IFRS 15), the fact that the change in accounting policy is made in accordance with its transitional provisions, the nature of the change in accounting policy (i.e. the fact that it is a mandatory change arising from the first application of an IFRS), a description of the transitional arrangements, and the impact of the change of policy on each financial statement line item affected, and on basic and diluted earnings per share (i.e. the quantitative disclosures listed in IAS 8.28(f)). However, the quantitative disclosures listed in IAS 8.28(f) on the impact of the change are only required for the reporting period immediately preceding the first period of application of IFRS 15 (in practice, the 2017 financial period). Therefore, unlike a “traditional” retrospective change of method, the impact is not required in the year of first application (in practice, 2018), nor for any additional comparative periods presented (in practice, 2016). Nevertheless, an entity may choose to present these disclosures if it so wishes;
- > an entity must also disclose the practical expedients chosen, where applicable (cf. **question 93**).



- **modified retrospective method:** an entity must provide disclosures concerning the financial reporting periods in which the date of first application falls (in our view, this will mean the 2018 interim and annual reporting periods in practice):
 - > the impact, on each financial statement line item in the reporting period, of applying IFRS 15 instead of IAS 11, IAS 18 and the associated Interpretations in effect before the change. In practice these disclosures will entail maintain double reporting during the first application year in order to provide the figures that would have been presented under the previous Standards (cf. **question 95**);
 - > the reasons explaining the main impacts described above.

In the interim financial statements for the year of first application, and in the absence of any more specific guidance in IAS 34 (a “description” of the nature and impact of a change in accounting policy, where necessary, is required in the list of minimum disclosures), our view is that there should be a reference to the disclosures required under IAS 8 in the event of a change of accounting policy (see above) and to the transitional information required by IFRS 15 (some of which amend the requirements of IAS 8). In the event of the modified retrospective method, some regulators (ESMA for Europe, for example) have recommended that the impact of the change of policy on the reporting period in which it first applies (generally 2018) should be reported as from the interim accounts.

95. What are the advantages and drawbacks of each of the transition methods offered by IFRS 15?

Each method has advantages and drawbacks which should be assessed in the light of an entity’s particular circumstances in order to identify the most relevant approach.

Figure 22

Transition method	Advantages	Drawbacks
Full retrospective method	— Financial statements are more consistent and comparable, since IFRS 15 is applied to all contracts with customers for all the periods presented — Useful and strengthened information on trends provided to users of financial statements — Several practical expedients	— Greater complexity, since IFRS 15 is applied to a larger number of contracts — Need to have conducted IFRS 15 diagnostic work as early possible so as to restate the comparative periods presented
Modified retrospective method	— Reduced complexity for the calculation of the initial application of IFRS 15 — Additional period of time in which to carry out IFRS 15 diagnostics	— Additional disclosures obliging entities to account for revenue during the first year of application using two different sets of accounts (i.e. according to IFRS 15 and under the previous Standards) — Limited disclosures on trends since comparative periods are not restated — Only two practical expedients



BACKGROUND

[QUESTIONS 96 TO 100]



96. What is the background to the publication of IFRS 15?

IFRS 15 was published in order to meet two main objectives:

- eliminate the inconsistencies and weaknesses of the previous Standards, providing entities using IFRSs with a more robust and detailed Standard covering even the most complex transactions, without any need to consult another set of standards or to develop an Interpretation; and
- improve the disclosure requirements (cf. **question 85**): the application of the previous Standards often resulted in disclosures that did not enable investors to understand an entity's revenue, nor the judgements and estimates used by the entity in accounting for this revenue.

IFRS 15 (and Topic 606 in US GAAP) also reflect the wish of the IASB (and the FASB, the US standard setter) to achieve convergence on a major subject, revenue recognition (cf. **question 97**).

97. How closely do IFRS and US GAAP principles on revenue recognition converge?

When IFRS 15 and Topic 606 were first published in May 2014, the two Standards converged totally, except with respect to:

- the collectability threshold (one of the criteria to be taken into account in step 1 to determine whether a contract with a customer exists under IFRS 15, cf. **question 11**): the conclusion that it is "probable" that an entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer does not have the same meaning under IFRS (where "probable" means "more likely than not", in practice implying a probability greater than 50%) and under US GAAP (where "probable" means "likely to occur", implying a higher threshold, equivalent to a concept of "highly likely");
- disclosures to be provided in interim periods (cf. **question 89**): in practice, interim disclosures under US GAAP are more numerous than in application of IAS 34;
- the effective date of the Standard and early application: listed US entities must apply Topic 606 to financial periods that are beginning as of 15 December 2017 (1 January 2018 for IFRS 15). Early application was only possible as of 15 December 2016 in US GAAP (the effective date of Topic 606 before the FASB decided to introduce a year's delay). IFRS 15 can be applied early from its publication date (once endorsed by the European Union, for entities in this area);
- impairment allowance recovery: consistently with IAS 36, under some circumstances, IFRS 15 requires the reversal of impairments previously recognised on assets corresponding to the costs to obtain or fulfil contracts. These reversals are prohibited under Topic 606, again consistently with the existing US GAAP;
- unlisted entities: Topic 606 applies to unlisted entities, with certain simplifications and a later effective date. There is no particular guidance for these entities in IFRS 15.

Following amendments by both the IASB and the FASB (see in particular the clarifications published by both standard-setters in April 2016), the two Standards also diverge at the following main points:

- identification of performance obligations: in particular, an entity applying Topic 606 does not have to analyse whether goods or services constitute a performance obligation if they are immaterial in the context of the contract with the customer. This is not explicitly stated in IFRS 15, although the materiality principle present in IFRS should generally lead to the same conclusion;
- licences: Topic 606 includes a presumption that a licence of intellectual property which is symbolic (i.e. has no material stand-alone functionality) provides the customer with a right to access the entity's intellectual property, for which revenue is recognised over time. In IFRS 15, symbolic licences of intellectual property can be classified as a right to use (for example, a "dead brand") for which revenue must be accounted for at a point in time (cf. **question 77**).

98. What is the Joint Transition Resource Group (TRG) and where can its work be consulted?

The Joint Transition Resource Group was created by the IASB and the FASB right after the publication of IFRS 15 and Topic 606 in May 2014. This group was charged with notifying the IASB and the FASB of problems raised by the implementation of the new revenue recognition Standard.

TRG members were preparers of financial statements, auditors and users representing a wide range of industries, geographical origins, and public and private companies and organisations.

The TRG met twice in 2014, four times in 2015 and twice in 2016 (on the American side only during this final year). In total around a hundred questions were put to the TRG, mainly from the US. Not all were publicly discussed, as some were handled directly by the staff.

The list of subjects addressed by the TRG can be consulted at:

<http://www.ifrs.org/-/media/feature/groups/trg-revenue-recognition/log-of-submissions.pdf>

While the TRG had no authority to publish official positions (like the IFRS Interpretations Committee), its discussions led the IASB (and the FASB) to publish amendments to IFRS 15 (and to Topic 606) in April 2016, in order to clarify the Standard.

TRG meetings were also routinely followed by the publication of meeting summaries drawn up by the staff and published on the IASB website. These summaries (and the staff papers, where these are expressly mentioned by the TRG as a reference source, especially for the examples presented) may be helpful in the interpretation of sometimes complex subjects.

These summaries can be downloaded free of charge from:

<https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#issues>



99. What Standards and Interpretations are replaced by IFRS 15?

[IFRS 15.C10]

IFRS 15 replaces IAS 11 on construction contracts, IAS 18 on the sale of goods and services and all the associated Interpretations: IFRIC 13 on customer loyalty programmes, IFRIC 15 on agreements for the construction of real estate, IFRIC 18 on the transfers of assets from customers and SIC-31 on barter transactions involving advertising services.

IFRS 15 consists of a Standard, application guidance with clarifications on certain topics (such as the sale of licences, sales with the right of return, customer options for additional goods or services at a discount, etc.), illustrative examples and the Basis for Conclusions. In total, this represents more than 400 pages on revenue recognition.

100. Are transactions for the sale of assets outside the entity's business activities affected by IFRS 15?

Yes, with respect to:

- the date of disposal of the assets; and
- the amount of consideration for inclusion in profit or loss arising from their derecognition.

Hence:

- the disposal date corresponds to the date at which the acquirer obtains control. This is determined in application of the provisions of IFRS 15 that determine when a performance obligation is satisfied (cf. **question 50**);
- the amount of consideration for inclusion in profit or loss following derecognition is determined in accordance with IFRS 15 provisions on the determination of the transaction price (and any subsequent modification) (cf. **question 27**).

These measures apply to the disposal of both tangible assets (IAS 16) and intangible assets (IAS 38).

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ABOUT MAZARS

ACCOUNTANCY, ADVISORY, TAX AND LEGAL SERVICES. AS OF 1ST JANUARY 2019, MAZARS OPERATES THROUGHOUT THE 86 COUNTRIES AND TERRITORIES THAT MAKE UP ITS INTEGRATED PARTNERSHIP. MAZARS DRAWS UPON THE EXPERTISE OF 20,000 WOMEN AND MEN LED BY 980 PARTNERS WORKING FROM 300 OFFICES WORLDWIDE. WE ASSIST CLIENTS OF ALL SIZES, FROM SMES TO MID-CAPS AND GLOBAL PLAYERS AS WELL AS START-UPS AND PUBLIC ORGANISATIONS, AT EVERY STAGE OF THEIR DEVELOPMENT.

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