



Proposed Accounting Standards Update

Issued: June 24, 2010
Comments Due: October 22, 2010

Revenue Recognition (Topic 605)

Revenue from Contracts with Customers

This Exposure Draft of a proposed Accounting Standards Update of Topic 605 is issued by the Board for public comment. Written comments should be addressed to:

Technical Director
File Reference No. 1820-100

The *FASB Accounting Standards Codification™* is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

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

The Board invites individuals and organizations to send written comments on all matters in this Exposure Draft of a proposed Accounting Standards Update. Responses from those wishing to comment on the Exposure Draft must be received in writing by October 22, 2010. Interested parties should submit their comments by email to director@fasb.org, File Reference No. 1820-100. Those without email should send their comments to “Technical Director, File Reference No. 1820-100, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116.” Do not send responses by fax.

All comments received constitute part of the FASB’s public file. The FASB will make all comments publicly available by posting them to its website and by making them available in its public reference room in Norwalk, Connecticut.

An electronic copy of this Exposure Draft is available on the FASB’s website until the FASB issues a final Accounting Standards Update.

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Proposed Accounting Standards Update

Revenue Recognition (Topic 605)

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Comment Deadline: October 22, 2010

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Introduction and Questions for Respondents

Why are the FASB and the IASB publishing this Exposure Draft?

- IN1. Revenue is a crucial number to users of financial statements in assessing a company's performance and prospects. However, revenue recognition requirements in U.S. generally accepted accounting principles (GAAP) differ from those in International Financial Reporting Standards (IFRSs), and both sets of requirements are considered to be in need of improvement. U.S. GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions. Although IFRSs provide less guidance on revenue recognition, the two main revenue recognition standards, IAS 18, *Revenue*, and IAS 11, *Construction Contracts*, can be difficult to understand and apply to transactions beyond simple transactions. In addition, those standards have limited guidance on important topics such as revenue recognition for multiple-element arrangements.
- IN2. Accordingly, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) initiated a joint project to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRSs that would:
- (a) remove inconsistencies and weaknesses in existing revenue recognition standards and practices;
 - (b) provide a more robust framework for addressing revenue recognition issues;
 - (c) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; and
 - (d) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.
- IN3. To meet those objectives, the FASB and the IASB have jointly developed a draft standard on revenue and, hence, are proposing amendments to the *FASB Accounting Standards Codification*TM and to IFRSs.

Who would be affected by the proposals?

- IN4. The proposed guidance would affect any entity that enters into contracts to provide goods or services that are an output of the entity's ordinary activities, unless those contracts are within the scope of other requirements of U.S. GAAP or IFRSs.

- IN5. In U.S. GAAP, the proposed guidance would supersede most of the guidance on revenue recognition in Topic 605. In IFRSs, the proposed guidance would supersede IAS 18 and IAS 11 and related Interpretations.
- IN6. In addition, the existing requirements for the recognition of a gain or loss on the sale of some nonfinancial assets that are not an output of the entity's ordinary activities (for example, property, plant, and equipment within the scope of Topic 360 or IAS 16, *Property, Plant and Equipment*, or IAS 40, *Investment Property*) would be amended to be consistent with the proposed revenue recognition and measurement requirements.
- IN7. Appendix B contains additional information on proposed amendments to the Accounting Standards Codification.

What are the main proposals?

- IN8. The proposed guidance specifies the principles that an entity would apply to report useful information about the amount, timing, and uncertainty of revenue and cash flows arising from its contracts to provide goods or services to customers. In summary, the core principle would require an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that it receives, or expects to receive, in exchange for those goods or services.
- IN9. To apply that principle, an entity would:
 - (a) identify the contract(s) with a customer;
 - (b) identify the separate performance obligations in the contract;
 - (c) determine the transaction price;
 - (d) allocate the transaction price to the separate performance obligations; and
 - (e) recognize revenue when the entity satisfies each performance obligation.
- IN10. The proposed guidance also specifies the accounting for some costs. An entity would recognize the costs of obtaining a contract as expenses when incurred. If the costs incurred in fulfilling a contract are not eligible for capitalization in accordance with other standards (for example, Topic 330 on inventory or IAS 2, *Inventories*), an entity would recognize an asset only if those costs:
 - (a) relate directly to a contract (or a specific contract under negotiation);
 - (b) generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
 - (c) are expected to be recovered.

Identify the contract(s) with a customer

- IN11. In most cases, an entity would apply the proposed guidance to a single contract. However, the proposals specify when an entity would combine two or more contracts and account for them as a single contract or segment a single contract and account for it as two or more contracts.

Identify the separate performance obligations in the contract

- IN12. A performance obligation is an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.
- IN13. If an entity promises to provide more than one good or service, it would account for each promised good or service as a separate performance obligation if the good or service is distinct.
- IN14. A good or service is distinct if either:
- (a) the entity, or another entity, sells an identical or similar good or service separately; or
 - (b) the entity could sell the good or service separately because the good or service has a distinct function and a distinct profit margin.

Determine the transaction price

- IN15. The transaction price is the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services promised in the contract. In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services.
- IN16. If the amount of consideration is variable (for instance, because of rebates, bonuses, penalties, or the customer's credit risk), an entity would recognize revenue from satisfying a performance obligation if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:
- (a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and
 - (b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.
- IN17. When determining the transaction price, an entity would consider the effects of the following:

- (a) collectibility;
- (b) the time value of money;
- (c) noncash consideration; and
- (d) consideration payable to the customer.

Allocate the transaction price to the separate performance obligations

- IN18. An entity would allocate the transaction price to all separate performance obligations in proportion to the standalone selling prices of the goods or services underlying each of those performance obligations at contract inception. If a standalone selling price is not directly observable, the entity would estimate it.
- IN19. The entity would update the transaction price over the life of the contract to reflect changes in circumstances and allocate changes in the transaction price to the separate performance obligations (see paragraph IN22).

Recognize revenue when a performance obligation is satisfied

- IN20. An entity would recognize revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.
- IN21. A customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. The proposed guidance includes indicators to assist an entity in determining when a customer has obtained control of a good or service.
- IN22. When an entity satisfies a performance obligation, an entity would recognize revenue in the amount of the transaction price allocated to the satisfied performance obligation. If the transaction price changes after contract inception, the amount of the change allocated to performance obligations already satisfied at the time the transaction price changes would be recognized as revenue in the period in which the transaction price changes.
- IN23. When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity would apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the customer. Acceptable methods include methods based on an entity's outputs or inputs and methods based on the passage of time.

How would the proposals affect U.S. GAAP and IFRSs?

- IN24. The Boards envisage that the accounting for revenue (and some costs) arising from contracts within the scope of the proposed guidance would be the same in both U.S. GAAP and IFRSs. However, differences might exist between U.S. GAAP and IFRSs in the profit margin reported in those contracts because of differences in other standards relating to accounting for the costs of fulfilling a contract (for example, Topic 330 or IAS 2).
- IN25. For some contracts (for example, many retail transactions), the proposed guidance would have little, if any, effect on current practice. However, the proposed guidance would differ from current practice in the following ways:
- (a) *recognition of revenue only from the transfer of goods or services*—contracts for the development of an asset (for example, construction, manufacturing, and customized software) would result in continuous revenue recognition only if the customer controls the asset as it is developed.
 - (b) *identification of separate performance obligations*—an entity would be required to divide a contract into separate performance obligations for goods or services that are distinct. As a result of those requirements, an entity might separate a contract into units of accounting that differ from those identified in current practice.
 - (c) *licensing and rights to use*—an entity would be required to evaluate whether a license to use the entity's intellectual property (for less than the property's economic life) is granted on an exclusive or nonexclusive basis. If a license is granted on an exclusive basis, an entity would be required to recognize revenue over the term of the license. That pattern of revenue recognition might differ from current practice.
 - (d) *effect of credit risk*—in contrast to some existing standards and practices, the effect of a customer's credit risk (that is, collectibility) would affect *how much* revenue an entity recognizes rather than *whether* an entity recognizes revenue.
 - (e) *use of estimates*—in determining the transaction price (for example, estimating variable consideration) and allocating the transaction price on the basis of standalone selling prices, an entity would be required to use estimates more extensively than in applying existing standards.
 - (f) *accounting for costs*—the proposed guidance specifies which contract costs an entity would recognize as expenses when incurred and which costs would be capitalized because they give rise to an asset. Applying that cost guidance might change how an entity would account for some costs.

- (g) *disclosure*—the proposed guidance specifies disclosures to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. An entity would be required to disclose more information about its contracts with customers than is currently required, including more disaggregated information about recognized revenue and more information about its performance obligations remaining at the end of the reporting period.

When would the proposals be effective?

IN26. The FASB and the IASB are working on various projects, including this project, as part of their commitment under the updated Memorandum of Understanding, *A Roadmap for Convergence between IFRSs and US GAAP—2006–2008*. Because the Boards expect to issue several standards in 2011, they plan to invite additional comment through a separate consultation on how best to change to the new requirements.

Questions for respondents

- IN27. The Boards invite individuals and organizations to comment on all matters in this Exposure Draft, particularly on the issues and questions below. Comments are requested from those who agree with the proposals as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposals are asked to describe their suggested alternatives, supported by specific reasoning.
- IN28. Respondents should submit one comment letter to either the FASB or the IASB. The Boards will share and jointly consider all comment letters received.

Recognition of revenue (paragraphs 8–33)

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

- (a) combine two or more contracts and account for them as a single contract;
- (b) segment a single contract and account for it as two or more contracts; and
- (c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

Question 2: The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

Measurement of revenue (paragraphs 34–53)

Question 4: The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

Question 5: Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

Question 6: Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Question 7: Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

Contract costs (paragraphs 57–63)

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

Question 9: Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

Disclosure (paragraphs 69–83)

Question 10: The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Question 11: The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

Implementation guidance (paragraphs IG1–IG96)

Question 14: The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

Question 15: The Boards propose that an entity should distinguish between the following types of product warranties:

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Question 16: The Boards propose the following if a license is not considered to be a sale of intellectual property:

- (a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and
- (b) if an entity grants a customer a nonexclusive license to use its intellectual property, it has a performance obligation to transfer the license and it satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the Boards? Why or why not?

Consequential amendments

Question 17: The Boards propose that in accounting for the gain or loss on the sale of some nonfinancial assets (for example, intangible assets and property, plant, and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Nonpublic entities

Question 18: Should any of the proposed guidance be different for nonpublic entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

Public roundtable meetings

IN29. The Boards plan to hold public roundtable meetings after the end of the comment period. The purpose of such meetings is to listen to the views of, and obtain information from, interested parties about the proposed guidance. The Boards plan to seek participants for the meetings that represent a wide variety of constituents (including users, preparers, auditors, and others) to ensure that they receive broad input. Any individual or organization wishing to participate must notify the FASB by sending an email by October 1, 2010, to Kenneth Bement, Project Manager, at kbbement@fasb.org containing a description of the issues suggested for discussion at the meetings. Any interested party also must submit its comments on the proposals in writing by October 22, 2010. Roundtable meetings can accommodate a limited number of participants. Depending on the number of responses received, the Boards may not be able to accommodate all requests to participate.

Proposed Guidance

Introduction

1. The Proposed Guidance section of this Exposure Draft specifies the accounting for revenue (and some costs) arising from contracts with customers. It does not address revenue arising from other transactions or activities (for example, revenues arising from changes in the value of some mineral, biological, or agricultural assets). The proposed amendments to the *FASB Accounting Standards Codification*[™] are not included in this Exposure Draft. The Boards expect to issue those proposed amendments and the proposed amendments to the XBRL Taxonomy during the comment period on this Exposure Draft. Appendix B provides a summary of those proposed amendments.
2. The core principle in the proposed guidance is that an entity shall recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration the entity receives, or expects to receive, in exchange for those goods or services. To apply the proposed guidance, an entity shall:
 - (a) identify the contract(s) with a customer;
 - (b) identify the separate performance obligations in the contract;
 - (c) determine the transaction price;
 - (d) allocate the transaction price to the separate performance obligations; and
 - (e) recognize revenue when the entity satisfies each performance obligation.
3. An entity shall consider the terms of the contract and all related facts and circumstances when using judgment in the application of the proposed guidance. An entity shall apply the proposed guidance consistently to contracts with similar characteristics and in similar circumstances.
4. The proposed guidance uses the terms in Appendix A with the specified meanings. Paragraphs in **bold type** state the main principles.

Objective

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

Scope

6. The proposed guidance applies to all contracts with customers except:
 - (a) lease contracts within the scope of Topic 840 on leases;
 - (b) insurance contracts within the scope of Topic 944 on insurance;
 - (c) contractual rights or obligations within the scope of the following Topics:
 - (i) Topic 310 on receivables;
 - (ii) Topic 320 on debt and equity securities;
 - (iii) Topic 405 on extinguishments of liabilities;
 - (iv) Topic 470 on debt;
 - (v) Topic 815 on derivatives and hedging;
 - (vi) Topic 825 on financial instruments; and
 - (vii) Topic 860 on transfers and servicing;
 - (d) guarantees (other than product warranties) within the scope of Topic 460 on guarantees; and
 - (e) nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange (for example, an exchange of oil to fulfill demand on a timely basis in a specified location).
7. A contract with a customer may be partially within the scope of the proposed guidance and partially within the scope of other Topics. If the other Topics specify how to separate and/or initially measure any parts of the contract, an entity shall first apply those separation and/or measurement requirements. If the other Topics do not specify how to separate and/or initially measure any parts of the contract, the entity shall apply the proposed guidance to separate and/or initially measure those parts of the contract.

Recognition of revenue

Identifying the contract

8. **An entity shall apply the proposed guidance to each contract identified in accordance with paragraphs 9–19.**
9. Contracts can be written, oral, or implied by the entity's customary business practice. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, and entities, and they may also vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining whether a contract exists.

10. A contract exists for the purpose of applying the proposed revenue requirements only if:
 - (a) the contract has commercial substance (that is, the entity's future cash flows are expected to change as a result of the contract);
 - (b) the parties to the contract have approved the contract and are committed to satisfying their respective obligations;
 - (c) the entity can identify each party's enforceable rights regarding the goods or services to be transferred; and
 - (d) the entity can identify the terms and manner of payment for those goods or services.
11. A contract does not exist for the purpose of applying the proposed guidance if either party can terminate a wholly unperformed contract without penalty. A wholly unperformed contract is a contract under which the entity has not transferred any goods or services and the customer has not paid any consideration.

Combination and segmentation of contracts (see paragraph IG2)

12. In most cases, an entity applies the proposed guidance to a single contract with a customer. However, in some cases, the amount and timing of revenue might depend on whether an entity combines contracts or segments a contract.
13. An entity shall combine two or more contracts and account for them as a single contract if the amount of consideration for goods or services in one contract is dependent on the amount of consideration for goods or services in another contract—in other words, the prices of the contracts are interdependent. Indicators that two or more contracts have interdependent prices include the following:
 - (a) the contracts are entered into at or near the same time;
 - (b) the contracts are negotiated as a package with a single commercial objective; and
 - (c) the contracts are performed either concurrently or consecutively.
14. The price of a contract is not interdependent with the price of another contract solely because the customer receives a discount on goods or services in the contract as a result of an existing customer relationship arising from previous contracts.
15. Conversely, an entity shall segment a single contract and account for it as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract. Goods or services are priced independently of other goods or

services in the same contract only if both of the following conditions are met:

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

16. If an entity segments a contract in accordance with paragraph 15, the entity shall allocate the total amount of consideration to each identified contract in proportion to the standalone selling prices of the goods or services in each identified contract (that is, on a relative standalone selling price basis). An entity shall allocate subsequent changes in the amount of consideration only to the identified contract to which those changes relate (for example, changes arising because the amount of consideration is variable as described in paragraphs 35 and 36).

Contract modifications (see paragraph IG3)

17. A contract modification is any change in the scope or price of a contract. Examples include changes in the nature or amount of the goods or services to be transferred, changes in the method or timing of performance, and changes in the previously agreed pricing in the contract. A contract modification may be initiated by either the customer or the entity.
18. An entity shall apply the proposed revenue requirements to a contract modification only if the conditions in paragraph 10 are met.
19. An entity shall account for a contract modification together with the existing contract if the prices of the modification and the existing contract are interdependent (as described in paragraph 13). In that case, the entity shall recognize the cumulative effect of the contract modification in the period in which the modification occurs. Hence, the cumulative accounting after the contract modification shall be the same as it would have been if the modification had been included in the existing contract. If the prices of the contract modification and the existing contract are not interdependent, the entity shall account for the contract modification as a separate contract.

Identifying separate performance obligations (see paragraphs IG4–IG43)

20. **An entity shall evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate performance obligation.**

21. Contracts with customers oblige an entity to provide goods or services in exchange for consideration. Goods or services include the following:
 - (a) goods produced by an entity for sale (for example, inventory of a manufacturer);
 - (b) goods purchased by an entity for resale (for example, merchandise of a retailer);
 - (c) arranging for another party to transfer goods or services (for example, acting as an agent of another party);
 - (d) standing ready to provide goods or services (for example, when-and-if available software products);
 - (e) constructing or developing an asset on behalf of a customer;
 - (f) granting licenses, rights to use, and options; and
 - (g) performing a contractually agreed task (or tasks).
22. If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation only if it is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in the contract as a single performance obligation.
23. A good or service, or a bundle of goods or services, is distinct if either:
 - (a) the entity, or another entity, sells an identical or similar good or service separately; or
 - (b) the entity could sell the good or service separately because the good or service meets both of the following conditions:
 - (i) it has a distinct function—a good or service has a distinct function if it has utility either on its own or together with other goods or services that the customer has acquired from the entity or are sold separately by the entity or by another entity; and
 - (ii) it has a distinct profit margin—a good or service has a distinct profit margin if it is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service.
24. When an entity transfers promised goods or services to a customer at the same time, it is not necessary to apply the proposed recognition and measurement requirements to each performance obligation separately if accounting for those performance obligations together would result in the same amount and timing of revenue recognition as if they were accounted for separately. For example, if an entity transfers two distinct services to a customer over the same time period, it could account for the promises to transfer those services as a single performance

obligation if applying the same revenue recognition method to both services would faithfully depict the transfer of services to the customer (as described in paragraph 32).

Satisfaction of performance obligations (see paragraphs IG44–IG73)

25. **An entity shall recognize revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service.**
26. A customer obtains control of a good or service when the customer has the ability to direct the use of, and receive the benefit from, the good or service. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.
27. The customer's ability to direct the use of a good or service (that is, an asset) refers to the present right to use the asset for its remaining economic life or to consume the asset in the customer's activities. The customer's ability to receive the benefit from an asset refers to its present right to obtain substantially all of the potential cash flows from that asset (either an increase in cash inflows or a decrease in cash outflows). The customer can obtain cash flows from an asset directly or indirectly in many ways such as by using, consuming, selling, exchanging, pledging, or holding the asset.
28. If an entity retains some rights to an asset solely as protection against the customer's failure to comply with the terms of the contract (for example, when an entity retains legal title as protection against the customer's failure to pay), those rights are protective rights and do not preclude a customer from obtaining control of an asset.
29. When assessing whether a customer obtains control of an asset, an entity shall consider any related arrangements entered into at or near the same time as, or in contemplation of, the contract (for example, repurchase agreements).
30. An entity shall assess the transfer of control of goods or services for each separate performance obligation. Indicators that the customer has obtained control of a good or service include the following:
 - (a) the customer has an unconditional obligation to pay—if a customer is unconditionally obliged to pay for a good or service, typically that is because the customer has obtained control of the good or service in exchange. An obligation to pay is unconditional

when nothing other than the passage of time is required before the payment is due.

- (b) the customer has legal title—legal title often indicates which party has the ability to direct the use of, and receive the benefit from, a good. Benefits of legal title include the ability to sell a good, exchange it for another asset, or use it to secure or settle debt. Hence, the transfer of legal title often coincides with the transfer of control. However, in some cases, possession of legal title is a protective right and may not coincide with the transfer of control to a customer.
- (c) the customer has physical possession—in many cases, the customer’s physical possession of a good gives the customer the ability to direct the use of that good. In some cases, however, physical possession does not coincide with control of a good. For example, in some consignment and in some sale and repurchase arrangements, an entity may have transferred physical possession but retained control of a good. Conversely, in some bill-and-hold arrangements, the entity may have physical possession of a good that the customer controls.
- (d) the design or function of the good or service is customer-specific—a good or service with a customer-specific design or function might be of little value to an entity because the good or service lacks an alternative use. For instance, if an entity cannot sell a customer-specific asset to another customer, it is likely that the entity would require the customer to obtain control of the asset (and pay for any work completed to date) as it is created. A customer’s ability to specify only minor changes to the design or function of a good or service or to choose from a range of standardized options specified by the entity typically would not indicate a customer-specific good or service. However, a customer’s ability to specify major changes to the design or function of the good or service would indicate that a customer obtains control of the asset as it is created.

31. Not one of the preceding indicators determines by itself whether the customer has obtained control of the good or service. Moreover, some indicators may not be relevant to a particular contract (for example, physical possession and legal title would not be relevant to services).

Continuous transfer of goods or services

32. When the promised goods or services underlying a separate performance obligation are transferred to a customer continuously, an entity shall apply to that performance obligation one revenue recognition method that best depicts the transfer of goods or services to the

customer. The entity shall apply that method consistently to similar performance obligations and in similar circumstances.

33. Suitable methods of recognizing revenue to depict the continuous transfer of goods or services to the customer include the following:
- (a) output methods that recognize revenue on the basis of units produced or delivered, contract milestones, or surveys of goods or services transferred to date relative to the total goods or services to be transferred. Output methods often result in the most faithful depiction of the transfer of goods or services. However, other methods may also provide a faithful depiction but at a lower cost.
 - (b) input methods that recognize revenue on the basis of efforts expended to date (for example, costs of resources consumed, labor hours expended, and machine hours used) relative to total efforts expected to be expended. Inputs often are more directly observable than outputs. However, a significant drawback of input methods is that there may not be a direct relationship between the efforts expended and the transfer of goods or services because of deficiencies in the entity's performance or other factors. When using an input method, an entity shall exclude the effects of any inputs that do not depict the transfer of goods or services to the customer (for example, the costs of abnormal amounts of wasted materials, labor, or other resources to fulfill the contract).
 - (c) methods based on the passage of time. An entity would recognize revenue on a straight-line basis over the expected duration of the contract if services are transferred evenly over time (for example, as in some licenses).

Measurement of revenue

34. **When an entity satisfies a performance obligation, it shall recognize as revenue the amount of the transaction price allocated to that performance obligation.**

Determining the transaction price (see paragraphs IG74–IG85)

35. An entity shall consider the terms of the contract and its customary business practice to determine the transaction price for the contract with the customer. The transaction price reflects the probability-weighted amount of consideration that an entity expects to receive from the customer in exchange for transferring goods or services.

36. In many contracts, the transaction price is readily determinable because the customer promises to pay a fixed amount of consideration and that payment is made at or near the time of the transfer of the promised goods or services. In other contracts, the amount of consideration is variable, and the transaction price must be estimated at each reporting period to represent faithfully the circumstances present at the reporting date and the changes in circumstances during the reporting period. The amount of consideration could vary because of discounts, rebates, refunds, credits, incentives, performance bonuses/penalties, contingencies, price concessions, the customer's credit risk, or other similar items.
37. If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognize a refund liability. The entity shall measure that liability at the probability-weighted amount of consideration that the entity expects to refund to the customer (that is, the difference between the amount of consideration received and the transaction price). The refund liability shall be updated at each reporting period for changes in circumstances.
38. An entity shall recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. The transaction price can be reasonably estimated only if both of the following conditions are met:
- (a) the entity has experience with similar types of contracts (or access to the experience of other entities if it has no experience of its own); and
 - (b) the entity's experience is relevant to the contract because the entity does not expect significant changes in circumstances.
39. Factors that reduce the relevance of an entity's experience include the following:
- (a) the consideration amount is highly susceptible to external factors (for example, volatility in the market, judgment of third parties, and risk of obsolescence of the promised good or service);
 - (b) the uncertainty about the amount of consideration is not expected to be resolved for a long time;
 - (c) the entity's experience with similar types of contracts is limited; and
 - (d) the contract has a large number of possible consideration amounts.
40. The existence of one or more of the above factors, in light of the significance of other factors, may not be sufficient to prevent an entity's making a reasonable estimate of the transaction price; likewise, other factors may preclude a reasonable estimate.

41. If the transaction price cannot be reasonably estimated, an entity shall not recognize revenue from satisfying a performance obligation. If circumstances change, the entity shall recognize revenue from satisfied performance obligations when the transaction price can be reasonably estimated. If an entity can reasonably estimate some, but not all, of the consideration amount (for example, if part of the total consideration is a fixed amount), the transaction price includes only the amount that the entity can reasonably estimate.
42. When determining the transaction price, an entity shall consider the effects of:
 - (a) collectibility;
 - (b) the time value of money;
 - (c) noncash consideration; and
 - (d) consideration payable to the customer.

Collectibility

43. Collectibility refers to the customer's credit risk—the customer's ability to pay the amount of promised consideration. In determining the transaction price, an entity shall reduce the amount of promised consideration to reflect the customer's credit risk. Hence, when an entity satisfies a performance obligation, the entity shall recognize revenue at the probability-weighted amount of consideration that the entity expects to receive. Once an entity has an unconditional right to consideration (that is, a receivable as described in paragraph 66), the effects of changes in the assessment of credit risk associated with that right to consideration shall be recognized as income or expense rather than as revenue.

The time value of money

44. In determining the transaction price, an entity shall adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicitly or implicitly).
45. The effect of the time value of money is not material to many contracts. However, the effect is material to some contracts because payment from the customer is due either significantly before or significantly after the transfer of goods or services to the customer. In those contracts, the entity shall reflect the time value of money in the transaction price by discounting the amount of promised consideration using the rate that would be used in a separate financing transaction between the entity and its customer. That rate shall reflect both the time value of money and credit risk (hence, an entity shall not also adjust the amount of the

promised consideration in accordance with paragraph 43). The entity shall present the effect of financing separately from the revenue from goods or services.

Noncash consideration

46. In some contracts, an entity receives, or expects to receive, noncash consideration. To determine the transaction price for those contracts, an entity shall measure noncash consideration (or promise of noncash consideration) at fair value. If an entity cannot reasonably estimate the fair value of the noncash consideration, it shall measure the consideration indirectly by reference to the standalone selling price of the goods or services transferred in exchange for the consideration.
47. If a customer contributes goods or services (for example, materials, equipment, or labor) to facilitate the fulfillment of the contract, an entity shall assess whether it obtains control of the contributed goods or services. If so, the entity shall account for the contributed goods or services as noncash consideration.

Consideration payable to the customer

48. If an entity pays, or expects to pay, consideration to the customer (or to other parties that purchase the entity's goods or services from the customer) in the form of cash or credit, or other items that the customer can apply against amounts owed to the entity, the entity shall determine whether that amount is:
 - (a) a reduction of the transaction price and, hence, of revenue (that is, the customer receives a discount on the entity's goods or services);
 - (b) a payment for a distinct good or service (as described in paragraph 23) that the customer supplies to the entity, in which case the entity shall account for the purchase of the good or service in the same way it accounts for other purchases from suppliers; or
 - (c) a combination of items (a) and (b), in which case the entity shall reduce the transaction price by the excess, if any, of consideration payable to the customer over the fair value of the good or service the entity receives from the customer. If the entity cannot reasonably estimate the fair value of the good or service received from the customer, the entity shall account for the entirety of the consideration payable to the customer as a reduction of the transaction price.

49. If consideration paid (or expected to be paid) to a customer is a reduction of the transaction price, an entity shall recognize the reduction of revenue when the later of the following occurs:
- (a) the entity transfers the promised goods or services to the customer; and
 - (b) the entity 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 practice.

Allocating the transaction price to separate performance obligations (see paragraphs IG86–IG88)

50. An entity shall allocate the transaction price to all separate performance obligations in proportion to the standalone selling price of the good or service underlying each of those performance obligations at contract inception (that is, on a relative standalone selling price basis).
51. The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately. A contractually stated price or a list price for a good or service shall not be presumed to represent the standalone selling price of that good or service. If a standalone selling price is not directly observable, an entity shall estimate it.
52. When estimating standalone selling prices, an entity shall maximize the use of observable inputs and shall apply estimation methods consistently for goods or services and customers with similar characteristics. Suitable estimation methods include the following:
- (a) expected cost plus a margin approach—an entity could forecast its expected costs of satisfying a performance obligation and then add the margin that the entity would require for that good or service; and
 - (b) adjusted market assessment approach—an entity could evaluate the market in which it sells goods or services and estimate the price that customers in that market would be willing to pay for those goods or services. That approach 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.

Allocating subsequent changes in the transaction price

53. After contract inception, an entity shall allocate any changes in the transaction price to all performance obligations on the same basis as at contract inception. Amounts allocated to satisfied performance

obligations shall be recognized as revenue, or a reduction of revenue, in the period in which the transaction price changes. An entity shall not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.

Onerous performance obligations

54. **An entity shall recognize a liability and a corresponding expense if a performance obligation is onerous.**
55. A performance obligation is onerous if the present value of the probability-weighted costs that relate directly to satisfying that performance obligation (as described in paragraph 58) exceeds the amount of the transaction price allocated to that performance obligation. Before an entity recognizes a liability for an onerous performance obligation, it shall recognize any impairment loss that has occurred on assets related to the contract (for example, inventory or an asset recognized in accordance with paragraph 57).
56. At each subsequent reporting date, an entity shall update the measurement of the liability for an onerous performance obligation using current estimates. An entity shall recognize changes in the measurement of that liability as an expense or as a reduction of an expense. When an entity satisfies the liability for an onerous performance obligation, it shall recognize the corresponding income as a reduction of an expense.

Contract costs (see paragraphs IG89 and IG90)

57. **If the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another Topic (for example, Topic 330 on inventory, Topic 360 on property, plant, and equipment, or Topic 985 on software), an entity shall recognize an asset only if those costs:**
- (a) **relate directly to a contract (or a specific contract under negotiation) as described in paragraph 58;**
 - (b) **generate or enhance resources of the entity that will be used in satisfying performance obligations in the future (that is, the costs relate to future performance); and**
 - (c) **are expected to be recovered.**
58. Costs that relate directly to a contract are:
- (a) direct labor (for example, salaries and wages of employees who provide services directly to the customer);

- (b) direct materials (for example, supplies used in providing services to the customer);
 - (c) allocations of costs that relate directly to the contract or contract activities (for example, costs of contract management, and depreciation of tools and equipment used in fulfilling the contract);
 - (d) costs that are explicitly chargeable to the customer under the contract; and
 - (e) other costs that were incurred only because the entity entered into the contract (for example, subcontractor costs).
59. An entity shall recognize the following costs as expenses when incurred:
- (a) costs of obtaining a contract (for example, the costs of selling, marketing, advertising, bid and proposal, and negotiations);
 - (b) costs that relate to satisfied performance obligations in the contract (that is, the costs that relate to past performance); and
 - (c) costs of abnormal amounts of wasted materials, labor, or other resources used to fulfill the contract.
60. If an entity cannot distinguish the costs that relate to future performance from the costs that relate to past performance, the entity shall recognize those costs as expenses when incurred.
61. **An asset recognized in accordance with paragraph 57 shall be amortized on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.**
62. An entity shall classify an asset recognized in accordance with paragraph 57 on the basis of the nature or function of the costs that gave rise to the asset (for example, intangible or work in process).
63. **An entity shall recognize an impairment loss to the extent that the carrying amount of an asset recognized in accordance with paragraph 57 exceeds the amount of the transaction price allocated to the remaining performance obligations less the costs that relate directly to satisfying those performance obligations (as described in paragraph 58).**

Presentation (see paragraph IG91)

64. **When either party to a contract has performed, the entity shall present the contract in the statement of financial position as either a contract asset or a contract liability depending on the relationship between the entity's performance and the customer's performance.**
65. If an entity performs by transferring goods or services to a customer before the customer performs by paying consideration, the entity shall

present the contract as a contract asset. Conversely, if a customer performs before an entity performs, the entity shall present the contract as a contract liability.

66. An entity shall present an unconditional right to consideration as a receivable (not as a contract asset) and shall account for that receivable in accordance with the guidance on receivables in Topic 310. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due.
67. An entity shall present any asset recognized in accordance with paragraph 57 separately from the contract asset or contract liability.
68. An entity shall present any liability recognized for an onerous performance obligation separately from any contract asset or contract liability.

Disclosure (see paragraphs IG92–IG96)

69. **To help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, an entity shall disclose qualitative and quantitative information about:**
 - (a) **its contracts with customers (paragraphs 73–80); and**
 - (b) **the significant judgments, and changes in judgments, made in applying the proposed guidance to those contracts (paragraphs 81–83).**
70. An entity shall consider the level of detail necessary to satisfy the disclosure requirements and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.
71. If the disclosures provided in accordance with the proposed guidance and other Topics do not meet the objective in paragraph 69, an entity shall disclose whatever additional information is necessary to meet that objective.
72. Other Topics (for example, Topic 280 on segment reporting) require an entity to present and disclose information related to revenue. The entity need not disclose information in accordance with the proposed guidance if it has provided the information in accordance with another Topic. However, an entity shall present and disclose the additional information in accordance with the proposed guidance in a way that shows how it relates to information required by that other Topic.

Contracts with customers

73. An entity shall disclose information about its contracts with customers to help users understand the amount, timing, and uncertainty of revenue and cash flows from those contracts, including:
- (a) a disaggregation of revenue for the period (paragraph 74);
 - (b) a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities (paragraphs 75 and 76); and
 - (c) information about the entity's performance obligations (paragraphs 77 and 78), including additional information about its onerous performance obligations (paragraphs 79 and 80).

Disaggregation of revenue

74. An entity shall disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Examples of categories that might be appropriate include:
- (a) type of good or service (for example, major product lines);
 - (b) geography (for example, country or region);
 - (c) market or type of customer (for example, government versus nongovernment customers); or
 - (d) type of contract (for example, a fixed-price versus a time-and-materials contract).

Reconciliation of contract balances

75. An entity shall provide a reconciliation from the opening to the closing aggregate balance of contract assets and contract liabilities. The reconciliation shall, at a minimum, show each of the following, if applicable:
- (a) the amount(s) recognized in the statement of comprehensive income arising from:
 - (i) revenue from performance obligations satisfied during the reporting period;
 - (ii) revenue from allocating changes in the transaction price to performance obligations satisfied in previous reporting periods;
 - (iii) interest income and expense; and
 - (iv) the effect of changes in foreign exchange rates;
 - (b) cash received;
 - (c) amounts transferred to receivables;

- (d) noncash consideration received; and
 - (e) contracts acquired in business combinations and contracts disposed.
76. An entity shall reconcile the opening and closing aggregate balance of contract assets and contract liabilities to the amounts presented in the statement of financial position.

Performance obligations

77. An entity shall disclose information about its performance obligations in contracts with customers, including a description of:
- (a) the goods or services the entity has promised to transfer, highlighting any performance obligations to arrange for another party to transfer goods or services (that is, if the entity is acting as an agent);
 - (b) when the entity typically satisfies its performance obligations (for example, upon shipment, upon delivery, as services are rendered, or upon completion of service);
 - (c) the significant payment terms (for example, whether the consideration amount is variable and whether the contract has a material financing component);
 - (d) obligations for returns, refunds, and other similar obligations; and
 - (e) types of warranties and related obligations.
78. For contracts with an original expected duration of more than one year, an entity shall disclose the amount of the transaction price allocated to the performance obligations remaining at the end of the reporting period that are expected to be satisfied in each of the following periods:
- (a) not later than one year;
 - (b) later than one year but not later than two years;
 - (c) later than two years but not later than three years; and
 - (d) later than three years.

Onerous performance obligations

79. An entity shall disclose the amount of any liability recognized for onerous performance obligations together with a discussion of:
- (a) the nature and amount of the performance obligations for which the liability has been recognized;
 - (b) why those performance obligations have become onerous; and
 - (c) when the entity expects to satisfy the liability.

80. An entity shall provide a reconciliation from the opening to the closing balance of the liability recognized for onerous performance obligations. The reconciliation shall show the amounts recognized in the statement of comprehensive income attributable to each of the following, if applicable:
- (a) performance obligations that became onerous during the period;
 - (b) performance obligations that ceased to be onerous during the period;
 - (c) amount of the liability that was satisfied during the period;
 - (d) the time value of money; and
 - (e) changes in the measurement of the liability that occurred during the reporting period.

Significant judgments in the application of the proposed guidance

81. An entity shall disclose the judgments, and changes in judgments, made in applying the proposed guidance that significantly affect the determination of the amount and timing of revenue from contracts with customers. That disclosure shall explain the judgments used in:
- (a) determining the timing of satisfaction of performance obligations (paragraph 82); and
 - (b) determining the transaction price and allocating it to performance obligations (paragraph 83).

Determining the timing of satisfaction of performance obligations

82. For performance obligations satisfied continuously, an entity shall disclose:
- (a) the methods (for example, output methods, input methods, and methods based on the passage of time) used to recognize revenue; and
 - (b) an explanation of why such methods are a faithful depiction of the transfer of goods or services.

Determining the transaction price and allocating it to performance obligations

83. An entity shall disclose information about the methods, inputs, and assumptions used:

- (a) to determine the transaction price in accordance with the proposed requirements in paragraphs 35–49;
- (b) to estimate standalone selling prices of promised goods or services;
- (c) to measure obligations for returns, refunds, and other similar obligations;
- (d) to measure the amount of any liability recognized for onerous performance obligations (including information about the discount rate).

Effective date and transition

- 84. An entity shall apply the proposed guidance for annual periods beginning on or after [date to be inserted after exposure].
- 85. An entity shall apply the proposed requirements retrospectively by applying the guidance on accounting changes and error corrections in paragraphs 250-10-45-5 through 45-10. In the period of adoption, an entity shall provide the disclosures required in paragraphs 250-10-50-1 through 50-3.

Implementation Guidance and Illustrations

IG1. The following implementation guidance and illustrations are an integral part of the proposed guidance:

- (a) segmentation of a contract (paragraph IG2);
- (b) contract modifications (paragraph IG3);
- (c) identifying performance obligations (paragraphs IG4–IG39);
- (d) determining whether a good or service is distinct (paragraphs IG40–IG43);
- (e) satisfaction of performance obligations (paragraphs IG44–IG73);
- (f) determining the transaction price (paragraphs IG74–IG85);
- (g) allocating the transaction price to separate performance obligations (paragraphs IG86–IG88);
- (h) contract costs (paragraphs IG89 and IG90);
- (i) presentation (paragraph IG91); and
- (j) disclosure (paragraphs IG92–IG96).

Segmentation of a contract (paragraphs 15 and 16)

IG2. Paragraph 15 requires an entity to segment a single contract and account for it as two or more contracts if the price of some goods or services in the contract is independent of the price of other goods or services in the contract. The following example illustrates a single contract that would be segmented and accounted for as two contracts.

Example 1—Contract segmentation

An entity enters into a contract with a customer to sell Products A, B, and C for \$36. The entity regularly sells Products A, B, and C separately for \$9, \$11, and \$20, respectively. It also regularly sells Products A and B together for \$16.

The entity segments the contract into two contracts: a contract to provide Products A and B, and a contract to provide Product C. The standalone selling price of Products A and B together (\$16) is independent of the standalone selling price of Product C. That is because the entity regularly sells Products A and B together at \$16 and Product C at \$20, and the customer does not receive a discount for buying Products A and B together with Product C (the total price for all of the products in the contract [\$36] equals the sum of the standalone selling prices for Products A and B together [\$16] and Product C [\$20]).

Example 1—Contract segmentation (continued)

The effect of segmenting the contract into two contracts is that the \$4 discount for purchasing Products A and B together is allocated only to Products A and B.

Contract modifications (paragraphs 17–19)

- IG3. Paragraph 19 requires an entity to account for a contract modification together with the existing contract if the prices of the modification and the existing contract are interdependent. The following example illustrates how an entity would apply that principle.

Example 2—Contract modifications

Scenario 1—services that do not have interdependent prices

An entity enters into a three-year services contract. The payment terms are \$100,000 payable annually in advance. The standalone selling price of the services at contract inception is \$100,000 per year. At the beginning of the third year (after the customer had paid the \$100,000 for that year), the entity agrees to reduce the price for the third year of services to \$80,000. In addition, the customer agrees to pay an additional \$220,000 for an extension of the contract for 3 years. The standalone selling price of the services at the beginning of the third year is \$80,000 per year.

To account for the contract modification, the entity must evaluate whether the price of the services provided before the contract modification and the price of the services provided after the contract modification are interdependent. The services provided during the first 2 years are priced at the standalone selling price of \$100,000 per year. Moreover, the services provided during the subsequent 4 years are priced at the standalone selling price of \$80,000 per year. Hence, the entity concludes that the price of the contract modification and the price of the original contract are not interdependent. Although the services are provided continuously, the price of the services in the first 2 years and the price of the subsequent services are negotiated at different times and in different market conditions (as evidenced by the significant change in the standalone selling price of the service).

Example 2—Contract modifications (continued)

Consequently, the entity accounts for the contract modification separately from the original contract. \$20,000 of the \$100,000 payment received at the beginning of the third year (before the modification) is a prepayment of services to be provided in the future years. Therefore, the entity recognizes revenue of \$100,000 per year for the 2 years of services provided under the original contract and \$80,000 per year for services provided during the subsequent 4 years of services under the new contract.

Scenario 2—services that have interdependent prices

The facts are the same as Scenario 1 except that at the beginning of the third year the customer agrees to pay an additional \$180,000 for an extension of the contract for 3 years.

The services provided during the first 2 years are priced at their standalone selling price of \$100,000 per year. However, the services provided during the subsequent 4 years are priced at a \$40,000 discount $[(\$80,000 \text{ standalone selling price per year} \times 4 \text{ years}) - (\$100,000 \text{ prepayment} + \$180,000 \text{ remaining payment})]$ and, therefore, their price is dependent on the price of the services in the original contract. Hence, the entity concludes that the price of the contract modification and the price of the original contract are interdependent.

Consequently, the entity accounts for the contract modification together with the original contract. At the date of modification, the entity recognizes the cumulative effect of the contract modification as a reduction to revenue in the amount of \$40,000 $[(\$480,000 \text{ total consideration} \div 6 \text{ years of total services} \times 2 \text{ years' services provided}) - \$200,000 \text{ revenue recognized to date}]$. The entity recognizes revenue of \$100,000 per year for the first 2 years' \$40,000 in the third year, and \$80,000 per year in the fourth, fifth, and sixth years.

Identifying performance obligations (paragraphs 20–24)

- IG4. Paragraph 20 requires an entity to evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or

service as a separate performance obligation. An entity shall consider the following guidance when applying that requirement:

- (a) sale of a product with a right of return (paragraphs IG5–IG12);
- (b) product warranties and product liabilities (paragraphs IG13–IG19);
- (c) principal versus agent considerations (paragraphs IG20–IG23);
- (d) customer options for additional goods or services (paragraphs IG24–IG26);
- (e) nonrefundable upfront fees (paragraphs IG27–IG30); and
- (f) licensing and rights to use (paragraphs IG31–IG39).

Sale of a product with a right of return

- IG5. In some contracts, an entity transfers a product to a customer and also grants the customer (either contractually or by customary business practice) the right to return the product to the entity. The likelihood of a return and the duration of the return period vary significantly across industries. For example, the perishable food industry typically has a lower rate of return and a shorter return period than the publishing industry.
- IG6. Reasons for a product's return include customer dissatisfaction with the product or the customer's failure to sell the product (if the customer is in the business of reselling products purchased from the entity). Contracts in which a customer may return a defective product shall be evaluated in accordance with the guidance on warranties in paragraphs IG13–IG19.
- IG7. A customer returning a product may receive any combination of the following:
- (a) a full or partial refund of any consideration paid;
 - (b) a credit that can be applied to amounts owed or to be owed for other goods or services; or
 - (c) another product in exchange.
- IG8. Exchanges by customers of one product for another of the same type, quality, condition, and price (for example, one color or size for another) are not considered returns for the purposes of applying the proposed requirements.
- IG9. An entity's promise to stand ready to accept a returned product during the return period shall not be accounted for as a separate performance obligation in addition to the obligation to provide a refund. Instead, an entity shall recognize both of the following:
- (a) revenue for the transferred goods that are not expected to be returned; and
 - (b) a refund liability (in accordance with paragraph 37).

- IG10. If an entity cannot reasonably estimate the probability of a refund to the customer in accordance with paragraphs 38–40, the entity shall not recognize revenue when it transfers the product but shall recognize any consideration received as a refund liability. In such cases, the entity shall recognize revenue when it can reasonably estimate the probability of a refund (which may be only when the return period expires).
- IG11. In accordance with paragraph 37, an entity shall update the measurement of the refund liability at the end of each reporting period for changes in expectations about the amount of refunds and make a corresponding adjustment to the amount allocated to the satisfied performance obligations.
- IG12. An entity shall recognize an asset (and corresponding adjustment to cost of sales) for its right to recover products from customers on settling the refund liability. The asset shall initially be measured by reference to the former carrying amount of the inventory less any expected costs to recover those products. Subsequently, an entity shall update the measurement of the asset to correspond with changes in the measurement of the refund liability.

Example 3—Right of return

An entity sells 100 products for \$100 each. The entity's customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The cost of each product is \$60. The entity estimates a 25 percent probability that 1 product will be returned, a 50 percent probability that 3 products will be returned, and a 25 percent probability that 5 products will be returned. Therefore, the entity expects that 3 products will be returned ($[1 \times 25\%] + [3 \times 50\%] + [5 \times 25\%]$).

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

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

(a) revenue of \$9,700 ($\100×97 products expected not to be returned);

(b) a refund liability for \$300 ($\100×3 products expected to be returned); and

Example 3—Right of return (continued)

(c) an asset of \$180 ($\60×3 products) for its right to recover products from customers on settling the refund liability. Hence, the amount recognized in cost of sales for 97 products is \$5,820 ($\60×97).

Product warranties and product liabilities

- IG13. It is common for an entity to provide (whether explicitly in the contract or implicitly by customary business practice) a product warranty with the sale of a product. In some contracts, the product warranty may be included in the selling price of the product. In other contracts, the warranty may be priced separately as an optional extra or may be provided by a party other than the seller of the product.
- IG14. An entity shall assess the objective of the product warranty. If its objective is to provide a customer with coverage for latent defects in the product (that is, defects that exist when the product is transferred to the customer but are not yet apparent), that warranty does not give rise to a performance obligation in addition to the performance obligation to transfer the product. Instead, the warranty requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. Therefore, at the reporting date the entity shall determine the likelihood and extent of defective products that it has sold to customers and, hence, the amount of unsatisfied performance obligations to transfer those products.
- IG15. Consequently, if the entity would be required to replace defective products, it does not recognize any revenue for those defective products when it transfers them to customers. If the entity would be required to repair defective products, it does not recognize revenue for the portion of the transaction price attributed to the products' components expected to be replaced in the repair process.
- IG16. An entity recognizes revenue only for products (or components of products) that are transferred to customers in the condition promised to customers. Otherwise, the entity would not have satisfied its performance obligations.

Example 4—Product warranty that is not a performance obligation

On December 31, an entity sells 1,000 products for \$1,000 each. The cost of each product is \$600. The entity is required by law to warrant its products against defects existing at the time of sale. For any defective product, the entity promises to replace the product during the first 90 days without additional charge. The entity's experience suggests that 1 percent of products sold contain defects at the time of sale and will be replaced. The entity refurbishes any defective products recovered from customers and sells them at a profit.

At December 31, the entity would estimate that it has provided 10 ($1,000 \times 1\%$) defective products that need to be replaced. Hence, for those products it recognizes remaining performance obligations of \$10,000 ($10 \text{ products} \times \$1,000$). It recognizes revenue for those products only when the customers obtain control of products without defects.

Because the entity has not satisfied all of its performance obligations at December 31 with respect to the products, the entity also would recognize an asset measured at \$6,000 ($10 \text{ products} \times \600 per product). That asset represents the inventory that the entity has not yet transferred to the customer and is measured in accordance with the guidance on inventory in Topic 330.

In this example, the entity can recognize that asset at \$6,000 because it can sell the refurbished products at a profit. However, if the defective products had little or no value (for instance, if they would be scrapped), the asset would be impaired.

At January 31, no products have been replaced, but conditions change so that the entity estimates that 12 products will need to be replaced. Hence, the entity recognizes remaining performance obligations of \$12,000 ($12 \text{ products} \times \$1,000$). The \$2,000 ($\$12,000 - \$10,000$) increase is recognized as a reduction of revenue. The entity also would increase the measurement of the asset to \$7,200 ($12 \text{ products} \times \600 per product) and recognize a corresponding adjustment to cost of sales.

- IG17. If the objective of a warranty is to provide a customer with coverage for faults that arise after the product is transferred to the customer, that warranty gives rise to a performance obligation for warranty services in addition to the performance obligation to transfer the promised product. Therefore, an entity shall allocate the transaction price (on a relative standalone selling price basis) between the promised product and the promised warranty service.
- IG18. In assessing whether the objective of the product warranty is to provide a customer with coverage for latent defects in the product or to provide a customer with coverage for faults that arise after the product is transferred to the customer, an entity considers factors such as:
- (a) whether the warranty is required by law—if the entity is required by law to provide a warranty, that indicates that the warranty is not a performance obligation, because such requirements typically exist to protect customers from the risk of purchasing defective products.
 - (b) whether the product could have been sold without the warranty—if the product could not be sold without a warranty, that indicates the warranty is not a performance obligation. Conversely, if a warranty is sold as an optional extra, it is a separate performance obligation in accordance with paragraph 23(a).
 - (c) the length of the warranty coverage period—the longer the coverage period, the more likely that the warranty (or part of the warranty) is a performance obligation because it is more likely to provide coverage for faults arising after the product is transferred to the customer.
- IG19. A law that requires an entity to pay compensation if its products cause harm or damage does not give rise to a performance obligation. For example, a manufacturer might sell products in a jurisdiction in which the law holds the manufacturer liable for any damages (for example, to personal property) that might be caused by a consumer using a product for its intended purpose. Similarly, an entity's promise to indemnify the customer for liabilities and damages arising from claims of patent, copyright, trademark, or other infringement by the entity's products does not give rise to a performance obligation. The entity shall account for such obligations in accordance with the guidance on loss contingencies in Subtopic 450-20.

Principal versus agent considerations

- IG20. In some contracts, an entity's customer might receive goods or services from a party other than the entity (for example, a service provider might procure and service equipment that is manufactured by another party). When other parties are involved in providing goods or services to an

entity's customer, the entity must determine whether its performance obligation is to provide the goods or services itself (that is, the entity is a principal), or to arrange for another party to provide those goods or services (that is, the entity is an agent). That determination affects whether the entity recognizes revenue in the amount of consideration received in exchange for those goods or services (if a principal) or in the amount of any fee or commission received in exchange for arranging for the other party to provide their goods or services (if an agent). An entity's fee or commission might be the net amount of consideration that the entity retains after paying other parties for providing their goods or services to the customer.

- IG21. If an entity obtains control of the goods or services of another party before it transfers those goods or services to the customer, the entity's performance obligation is to provide the goods or services itself. Hence, the entity is acting as a principal and shall recognize revenue in the gross amount receivable from the customer.
- IG22. Indicators that the entity's performance obligation is to arrange for the provision of goods or services by another party (that is, that the entity is an agent and shall recognize revenue net) include the following:
- (a) the other party is primarily responsible for fulfillment of the contract;
 - (b) the entity does not have inventory risk before or after the customer order, during shipping, or on return;
 - (c) the entity does not have latitude in establishing prices for the other party's goods or services and, hence, the benefit that the entity can receive from those goods or services is constrained;
 - (d) the entity's consideration is in the form of a commission; and
 - (e) the entity does not have customer credit risk for the amount receivable in exchange for the other party's goods or services.
- IG23. If an entity transfers a performance obligation to another party so that the entity is no longer obliged to provide the underlying good or service to the customer (that is, the entity is no longer acting as the principal), the entity shall not recognize revenue for that performance obligation. Instead, the entity shall evaluate whether to recognize revenue for satisfying a performance obligation to obtain a customer for the other party (that is, whether the entity is acting as an agent).

Customer options for additional goods or services

- IG24. In many contracts, an entity grants a customer the option to acquire additional goods or services free of charge or at a discount. Those options come in many forms, including sales incentives, customer award credits (or points), contract renewal options, or other discounts on future goods or services.

- IG25. If an entity grants a customer the option to acquire additional goods or services, that promise gives rise to a separate performance obligation in the contract only if the option provides a material right to the customer that the customer would not receive without entering into that contract (for example, a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market). If the option provides a material right, the customer in effect pays the entity in advance for future goods or services and the entity recognizes revenue when those future goods or services are transferred or when the option expires.

Example 5—Sale of a product and a future discount

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

Because the discount voucher provides a material right to the customer that the customer would not receive without entering into that contract, the entity concludes that the discount voucher is a separate performance obligation in the contract for the sale of Product A. (Example 25 illustrates how much of the transaction price of \$100 would be allocated to the discount voucher.)

- IG26. If a customer has the option to acquire an additional good or service at a price that is within the range of prices typically charged for those goods or services, that option does not provide the customer a material right even if the option can be exercised only because of entering into a previous contract. The entity has merely made a marketing offer.

Example 6—Telecommunication services

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

Example 6—Telecommunication services (continued)

The entity determines that the customer's fixed monthly payments do not include a prepayment for future services because the prices of the additional call minutes and texts are within the range of prices typically charged for those services.

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

Nonrefundable upfront fees

- IG27. In some contracts, an entity charges a customer a nonrefundable upfront fee at or near contract inception. Examples include joining fees in health club membership contracts, activation fees in telecommunication contracts, setup fees in outsourcing contracts, and initial fees in supply contracts.
- IG28. To identify performance obligations in such contracts, an entity shall assess whether the fee relates to the transfer of a promised good or service. In many cases, even though a nonrefundable upfront fee relates to an activity that the entity is required to undertake at or near contract inception to fulfill the contract, that activity does not result in the transfer of a promised good or service to the customer. Rather, the upfront fee is an advance payment for future goods or services and, hence, would be recognized as revenue when those future goods or services are provided. That revenue recognition period would extend beyond the initial contractual period if the entity grants the customer the option to renew the contract and that option provides the customer with a material right as discussed in paragraphs IG24–IG26.

Example 7—Nonrefundable upfront fees

Scenario 1—health club membership

A health club entity enters into a contract with a customer for one year of access to any of its health clubs. The entity charges the customer a nonrefundable joining fee in part as compensation for the initial activities of registering the customer. The customer can renew the contract each year without paying the joining fee.

The entity's activity of registering the customer does not transfer any service to the customer and, hence, is not a performance obligation. The customer's right to access the entity's health clubs over a specified period is a right that the customer has as a result of entering into the contract. The promised service under the contract (access to a chain of health clubs) can be provided to the customer only over time. Therefore, the joining fee is included in the transaction price allocated to the performance obligation to provide access to the health clubs and to the option to renew. Consequently, the nonrefundable joining fee is recognized as revenue during the period that the entity expects to provide services to the customer.

Scenario 2—payroll processing

A payroll processing entity charges a nonrefundable setup fee at contract inception in addition to the periodic fees for the ongoing payroll processing services. The setup fee compensates the entity for its activities of establishing the necessary records in its systems in order to be able to provide the payroll processing services. The customer can renew the contract each year without paying the setup fee.

The entity's activities in establishing the records in its systems do not transfer any service to the customer and, hence, are not a performance obligation. The promised service under the contract is the payroll processing. Accordingly, the setup fee is included in the transaction price allocated to the performance obligation to provide payroll processing and to the option to renew. Consequently, the nonrefundable setup fee is recognized as revenue during the period that the entity expects to provide services to the customer.

- IG29. If the nonrefundable upfront fee relates to a performance obligation, the entity shall evaluate whether to account for that performance obligation separately in accordance with paragraphs 20–24.
- IG30. An entity may charge a nonrefundable fee in part as compensation for costs incurred in setting up a contract. If those setup activities do not satisfy a separate performance obligation, the entity shall exclude those costs from any method of revenue recognition that uses the basis of costs of resources consumed to date relative to the costs of total resources expected to be consumed (in accordance with paragraph 33(b)). That is because the costs of setup activities do not depict the transfer of services to the customer. The entity shall evaluate whether costs incurred in setting up a contract have resulted in an asset in accordance with paragraph 57.

Licensing and rights to use

- IG31. Licensing refers to an entity's granting a customer the right to use, but not own, intellectual property of the entity. Intellectual property includes all of the following:
- (a) software and technology;
 - (b) motion pictures, music, and other forms of media and entertainment;
 - (c) franchises;
 - (d) patents, trademarks, and copyrights; and
 - (e) other intangible assets.
- IG32. Topic 840 provides guidance on rights to use specified types of assets.
- IG33. If a customer obtains control of substantially all the rights associated with the entity's intellectual property, the contract shall be considered to be a sale rather than licensing of the intellectual property. That would be the case, for instance, if an entity grants a customer the exclusive right to use its intellectual property for substantially all of the property's economic life.
- IG34. If a customer does not obtain control of substantially all the rights associated with the entity's intellectual property and the entity has promised to grant exclusive rights to the customer, the entity has a performance obligation that it satisfies continuously during the period in which it permits the customer to use its intellectual property.
- IG35. If an entity grants rights that are not exclusive, the promised rights give rise to a single performance obligation. The entity satisfies that performance obligation when the customer is able to use and benefit from the rights, which is no sooner than the beginning of the license period.

- IG36. Rights to use are not exclusive if an entity can grant similar rights to other customers under substantially the same terms. For example, with many software products, entities grant similar rights to many customers under substantially the same terms.
- IG37. An entity might grant rights to more than one customer to use the same intellectual property. However, the rights of one customer might substantially differ from the rights granted to another customer. Hence, those rights would be exclusive. An entity might grant exclusive rights on the basis of the following:
- (a) time—for example, a motion picture studio granting one customer the exclusive right to air a television series during one time period and granting another customer the exclusive right to air the same series during another time period;
 - (b) geography—for example, a franchisor granting one customer the exclusive right to a franchise in a particular region and granting another customer the exclusive right to the franchise in a different region;
 - (c) distribution channel or medium—for example, a record label granting one customer the exclusive right to distribute a soundtrack on compact disc and granting another customer the exclusive right to distribute the soundtrack via the Internet.
- IG38. If an entity has a patent to intellectual property that it licenses to customers, the entity may represent and guarantee to its customers that it has a valid patent, and it will defend and maintain that patent. That promise to maintain and defend patent rights is not a performance obligation because it does not transfer a good or service to the customer. Defending a patent protects the intellectual property to which the entity has represented itself as having enforceable rights.
- IG39. The following example illustrates how an entity would identify performance obligations when the entity grants a customer the right to its intellectual property.

Example 8—Franchise rights

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

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

The exclusive rights to the trade name, market area, and proprietary know-how for five years are not distinct because individually they do not have a distinct function. However, on a combined basis, those rights have a distinct function because they provide utility together with other services that are sold separately. Hence, those rights give rise to a separate performance obligation. Because those rights are exclusive to a specified region, the entity satisfies the performance obligation to grant those rights continuously during the five-year contract.

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

The entity's promise to stand ready to provide products to the customer in the future would not be accounted for as a separate performance obligation in the contract because it does not provide the customer with a material right (as described in paragraphs IG24–IG26).

Example 8—Franchise rights (continued)

In accordance with the guidance in paragraphs 38–40, the entity concludes that it cannot reasonably estimate the future royalty payments because the franchise has not yet operated in that specific region and the entity does not have experience with that type of franchise agreement. Hence, the entity allocates the fixed fee to the performance obligations for the rights, the training services, and the equipment on a relative standalone selling price basis.

Determining whether a good or service is distinct (paragraph 23)

IG40. Paragraph 23 requires an entity to identify separate performance obligations by determining whether a good or service is distinct. If a good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct.

IG41. The following example illustrates a good and a service that are distinct.

Example 9—Specialized equipment with installation

An entity enters into a contract to sell and install specialized equipment that it has manufactured. The installation could be performed by other entities in the industry.

The equipment is distinct because, although the entity does not sell the equipment separately, the entity could sell it separately. The equipment has a distinct function because, although the equipment does not have utility on its own without the installation, it has utility together with installation services that are sold separately. Moreover, the profit margin on the equipment is distinct because it is subject to distinct risks and the entity can separately identify the resources required to provide the equipment.

The installation services are distinct because similar services are sold by other entities separately.

**Example 9—Specialized equipment with installation
(continued)**

Therefore, the entity would identify separate performance obligations for the equipment and for the installation. However, in accordance with paragraph 24 the entity would not need to account for them separately if the customer obtains control of the equipment only after it has been installed.

IG42. The following example illustrates a license that is not distinct.

**Example 10—Technology license with research and
development services**

A biotechnology entity enters into a contract with a customer and promises:

(a) to grant to the customer exclusive rights to use the entity's Technology A for the life of its patent. The license gives the customer the exclusive right to market, distribute, and manufacture Drug B as developed using Technology A.

(b) to provide research and development services to the customer. The entity agrees to assign four full-time equivalent employees to the research and development services. The objective is to receive regulatory approval to market and distribute Drug B using Technology A.

The customer must use the entity to perform the research and development services necessary to develop Drug B using Technology A because the know-how and expertise related to Technology A are proprietary to the entity and not available from other entities.

In this example, the license is not distinct because it neither is sold separately (that is, without the research and development services) nor could it be because it does not have a distinct function. The license does not provide utility on its own or together with other goods or services that the customer has received from the entity or that are available from other entities. (If comparable services were sold separately by other entities, the license would have a distinct function.)

Example 10—Technology license with research and development services (continued)

Therefore, the entity would combine the license with the research and development services and account for them as a single performance obligation.

- IG43. The following example illustrates how an entity would identify separate performance obligations on the basis of whether each good or service is distinct and when the promised goods or services are transferred.

Example 11—Construction contract

An entity enters into a contract to construct a facility for a customer. The construction project requires engineering (design), procurement, and construction activities. The design of the facility is specific to the customer's requirements, and the customer is involved in specifying major structural and functional elements of the facility. The entity procures materials and equipment as they are needed during construction. The customer obtains control of those materials and equipment as they are installed. The construction of the facility is expected to take three years. The entity also guarantees that the facility will operate in accordance with agreed-upon specifications for two years from the date of completion of construction. Other entities could provide similar services.

The design services are distinct because similar services are sold separately by the entity and by its competitors.

In this example, procurement of the materials and equipment is not a performance obligation. Procurement is an activity that is necessary for the entity to obtain control of the promised materials and equipment and then to transfer them to the customer. Because the customer obtains control of the materials and equipment only as they are installed, they are transferred to the customer at the same time as the related installation services. Hence, the entity accounts for the materials and equipment together with the related installation service (in accordance with paragraph 24).

Example 11—Construction contract (continued)

During construction, the entity performs various tasks including site preparation, foundation development, structure erection, piping, wiring, and site finishing (for example, paving a parking lot and landscaping). The customer could contract separately with other entities to perform each of those tasks. However, some of the tasks are highly interrelated, which requires the entity to provide a significant contract management service. That service includes managing and coordinating those tasks and covering the risk that those tasks do not combine to provide the integrated construction services for which the customer has contracted.

The contract management service is not distinct. Similar services are not sold separately because the entity is integrating, and covering the risks of, a unique combination of tasks. The contract management service has a distinct function, but it does not have a distinct profit margin. The entity can separately identify the resources to provide the contract management service. However, the contract management service is not subject to distinct risks because the risks are inseparable from the risks of the related tasks.

Because the contract management service is not distinct, the entity combines that service with the related tasks with inseparable risks. The entity identifies distinct risks for site preparation and site finishing. Hence, the entity accounts for those services as separate performance obligations. The remaining construction tasks are accounted for as a single performance obligation.

The entity would account for the performance guarantee as a warranty as discussed in paragraphs IG13–IG19.

Satisfaction of performance obligations (paragraphs 25–33)

- IG44. Paragraph 25 requires an entity to recognize revenue when it satisfies a performance obligation identified in accordance with paragraphs 20–24 by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. An entity shall consider the following guidance when applying that requirement:

- (a) software license (paragraph IG45);
- (b) shipment of a product with risk of loss (paragraph IG46);
- (c) sale and repurchase of an asset (paragraphs IG47–IG53);
- (d) consignment arrangements (paragraphs IG54–IG57);
- (e) bill-and-hold arrangements (paragraphs IG58–IG62);
- (f) determining whether goods or services are transferred continuously (paragraphs IG63–IG68); and
- (g) customer acceptance (paragraphs IG69–IG73).

Software license

IG45. The following example illustrates how an entity would determine when it satisfies a performance obligation when the entity licenses or grants a customer the right to its intellectual property.

Example 12—Software license

An entity has previously licensed, on a nonexclusive basis, Product X to a customer on a compact disc that also included a copy of Products Y and Z. Each product requires an access code for the customer to use the software. Upon delivery of the compact disc, the entity provided the access code to Product X, but not for Products Y and Z.

At the reporting date, the entity licenses Product Y to the customer but provides the access code to Product Y after the reporting date.

In this example, the customer does not obtain control of the rights to Product Y at the reporting date because the customer cannot use Product Y until it obtains the access code. Therefore, the entity would recognize revenue for Product Y when the customer obtains the access code and, hence, the entity satisfies its performance obligation.

Shipment of a product with risk of loss

IG46. The following example illustrates how an entity would identify performance obligations and determine when it satisfies them if the entity retains the risk of loss during shipment of the product.

Example 13—Free on board shipping point and risk of loss

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

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

In this example, the additional performance obligation for risk coverage does not affect when the customer obtains control of the product. However, it does result in the customer's receiving a service from the entity while the product is in transit. Hence, the entity has not satisfied all of its performance obligations at the point of shipment and would not recognize all of the revenue at that point. Some revenue would be recognized as it covers the risk of loss during transit (subject to materiality).

Sale and repurchase of an asset

- IG47. Sometimes an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract). The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.
- IG48. Repurchase agreements come in three main forms:
- (a) an entity's unconditional obligation to repurchase the asset (a forward);
 - (b) an entity's unconditional right to repurchase the asset (a call option); and

- (c) a customer's unconditional right to require the entity to repurchase the asset (a put option).
- IG49. If an entity has an unconditional obligation or unconditional right to repurchase the asset (a forward or a call option), the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset. Hence, the customer does not obtain control of the asset (even though the customer may have physical possession of the asset), and the entity shall account for the sale and repurchase agreement as:
- (a) a right of use in accordance with Topic 840, if the entity repurchases the asset for an amount that is less than the original sales price of the asset; or
 - (b) a financing arrangement, if the entity repurchases the asset for an amount that is equal to or more than the original sales price of the asset.
- IG50. When comparing the repurchase price with the sales price, an entity shall adjust the prices to reflect the effects of the time value of money, if material.
- IG51. If the sale and repurchase agreement is a financing arrangement, the entity shall continue to recognize the asset and shall recognize a financial liability for any consideration received from the customer. The entity shall recognize the difference between the amount of consideration received from the customer and the amount of consideration paid to the customer as interest and, if applicable, holding costs (for example, insurance).
- IG52. If a customer has the unconditional right to require the entity to repurchase the asset (a put option), the customer obtains control of the asset and the entity shall account for the agreement similarly to the sale of a product with a right of return as discussed in paragraphs IG5–IG12. The following example illustrates how an entity would account for the sale of an asset with a put option.

Example 14—Sale and repurchase of an asset

An entity sells an asset for \$100,000 and grants the customer the option to return the asset and receive a refund of \$100,000. The cost of the asset is \$70,000. The entity estimates a 50 percent probability that the asset will be returned.

Upon transfer of control of the asset, the entity would:

(a) derecognize the asset:

Dr cost of sales	\$70,000	
Cr inventory		\$70,000

(b) recognize revenue and a repurchase liability:

Dr cash	\$100,000	
Cr repurchase liability	\$50,000	(\$100,000 × 50%)
Cr revenue	\$50,000	(\$100,000 – \$50,000)

(c) recognize an asset for its right to recover the asset on settling the repurchase liability:

Dr right to receive asset	\$35,000	(\$70,000 × 50%)
Cr cost of sales		\$35,000

If the customer exercises its option to require the entity to repurchase the asset, the entity would:

(a) settle the repurchase liability and adjust the revenue previously recognized:

Dr repurchase liability	\$50,000	
Dr revenue	\$50,000	
Cr cash		\$100,000

Example 14—Sale and repurchase of an asset (continued)

(b) recognize the repurchased asset:

Dr inventory	\$70,000	
Cr right to receive asset		\$35,000
Cr cost of sales		\$35,000

IG53. If the terms of the put and related facts and circumstances make it virtually certain that the customer will exercise the put option (for example, because the customer is a financial institution and would incur a significant loss if it does not exercise the option), the entity would recognize a repurchase liability for virtually the full amount of consideration received from the customer.

Consignment arrangements

IG54. Some entities deliver products to other parties (for example, dealers or distributors) on a consignment basis. Those arrangements help the entity to move its inventory closer to the point of sale to end customers and provide the other party with a wider range of inventory than might otherwise be practicable.

IG55. When an entity delivers a product to another party such as a dealer or a distributor for sale to end customers, an entity shall evaluate whether the dealer or distributor has obtained control of the product at that point in accordance with paragraphs 26–31.

IG56. Typically, inventory on consignment is owned by the entity until a specified event occurs, such as the sale of the product to a customer of the dealer, or until a specified period expires. Until that point, the entity typically is able to require the return of the products or transfer them to another dealer. Moreover, the dealer typically does not have an unconditional obligation to pay for the products (although it might be required to pay a deposit). Accordingly, the entity would not recognize revenue upon delivery of the products to the dealer.

IG57. If the dealer or distributor obtains control of the product before transferring the product to an end customer, it is a principal as discussed in paragraphs IG20–IG23 and shall recognize revenue when its customer obtains control of the product. If the dealer or distributor does not obtain control of the product, then it is an agent as discussed in paragraphs IG20–IG23 and shall recognize revenue when it has provided the service of arranging for the transfer of the product.

Bill-and-hold arrangements

- IG58. In some contracts, an entity bills a customer for a product but does not ship the product until a later date (a bill-and-hold arrangement). For example, a customer may request an entity to enter into such contracts because of a lack of available space for the product or because of delays in its production schedules or because it has more than sufficient inventory in its distribution channel.
- IG59. An entity determines when it has satisfied its performance obligation to transfer a product by evaluating when the customer obtains control of that product in accordance with paragraphs 26–31. In most contracts, that will be when the product is either delivered to the customer's delivery site or shipped to the customer, depending on the terms of the contract, including delivery or shipping terms. However, a customer may have obtained control of a product even though that product remains in the physical possession of the entity. In such cases, the customer has the ability to direct the use of, and receive the benefit from, the product even though it has decided to not exercise its right to use that product. Consequently, the entity does not have the ability to direct the use of, and receive the benefit from, the product. Instead the entity provides custodial services to the customer over the customer's asset.
- IG60. Accordingly, for a customer to have obtained control of a product in a bill-and-hold arrangement:
- (a) the customer must have requested the contract to be on a bill-and-hold basis;
 - (b) the product must be identified separately as the customer's;
 - (c) the product currently must be ready for delivery at the location and time specified, or to be specified, by the customer; and
 - (d) the entity cannot use the product or sell it to another customer.
- IG61. In addition to evaluating whether the customer has obtained control of a product in a bill-and-hold arrangement in accordance with paragraphs 26–31, the entity also considers the conditions in paragraph 10 to assess whether a contract exists.
- IG62. If an entity recognizes revenue from the sale of a product on a bill-and-hold basis, the entity shall consider whether the custodial services are a material separate performance obligation to which some of the transaction price shall be allocated.

Determining whether goods or services are transferred continuously

- IG63. In most contracts, it is straightforward to determine whether an entity has promised to transfer goods or services continuously or to transfer them

at a point in time. In some contracts, however, it can be difficult to make that determination, particularly when an entity promises to produce, manufacture, or construct an asset specifically for a customer (for example, construction-type, production-type, and software development contracts). That determination affects whether an entity satisfies a performance obligation (and recognizes revenue) continuously throughout the contract or only at the end of the contract when the customer obtains control of the completed asset.

- IG64. In such cases, an entity shall determine whether it has promised to transfer goods or services continuously by evaluating whether the customer controls the asset as it is produced, manufactured, or constructed. Therefore, in accordance with the proposed guidance in paragraphs 26–31, the entity shall consider whether the customer has the ability to direct the use of, and receive the benefit from, the work in process (rather than the completed asset). If the customer has that ability, the contract is to transfer goods or services continuously to the customer, and the entity would recognize revenue continuously to depict that transfer.
- IG65. If the customer does not control the asset as it is produced, manufactured, or constructed, the contract is to transfer a completed asset. In that situation, an entity shall recognize revenue only when the customer obtains control of the completed asset.
- IG66. The following example illustrates situations in which the entity's contract is to provide services and those in which the entity's contract is to provide a completed asset.

Example 15—Manufacturing services versus manufactured equipment

Scenario 1—manufacturing services

A manufacturer enters into a contract with a customer on January 1 to build highly customized equipment to be delivered to the customer on December 31 for a fixed price of \$240,000. Nonrefundable progress payments are made on a quarterly basis for work completed during the quarter.

The equipment is manufactured at the entity's facility. Because the equipment is customized for the particular customer, the customer is highly involved in specifying the design of the equipment and the manufacturing process. For instance, the customer can specify changes to the equipment throughout the manufacturing process for additional consideration. Legal title to the equipment passes to the customer upon delivery of the equipment. If the contract is terminated before manufacturing of the equipment is finished, the customer retains the part-completed equipment and must pay for any work completed to date.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer controls the equipment as it is manufactured. The customer has an unconditional obligation to pay throughout the contract as evidenced by the required progress payments (with no refund of payment for any work performed to date) and by the requirement to pay for any partially completed equipment in the event of contract termination. In addition, the customer specifies the design of the equipment and has involvement in the manufacturing process. The customer also has the ability to take possession of the equipment during manufacturing and engage another entity to complete the manufacturing. Consequently, the manufacturer cannot direct the use of, and receive the benefit from, the equipment. Although the customer does not obtain legal title of the equipment until delivery of the complete or part-complete equipment, the entity's retention of title is a protective right, and not an indicator that the entity has retained control.

Consequently, the entity's performance obligation is to provide the customer with materials and services continuously because the customer controls the equipment throughout the manufacturing process. Paragraph 33 provides guidance on selecting a revenue recognition method for that performance obligation.

Example 15—Manufacturing services versus manufactured equipment (continued)

Scenario 2—manufactured equipment

On January 1, a manufacturer enters into a contract with a customer for equipment to be delivered to the customer on December 31 for a fixed price of \$240,000. The customer is obliged to make quarterly payments of \$60,000.

The equipment is manufactured at the entity's facility and is of a standard design, although the entity typically manufactures equipment only when it has a contract. Hence, the customer is able to specify only minor aspects of the design of the equipment. Legal title to the equipment passes to the customer upon delivery of the equipment. If the customer cancels the contract before the equipment is delivered, the customer compensates the entity for any loss of profit on sale of the equipment to another customer.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer does not obtain control of the equipment until it is delivered. The customer is not involved in the design of the equipment and does not have managerial involvement throughout the contract. Also, the customer cannot take possession of the equipment until it is ready for delivery. Although the customer has unconditional obligations to make payments to the entity over the duration of the contract, those payments would be recoverable in full if the entity did not deliver the equipment. The customer does not have the ability to limit the entity's rights to the equipment and, therefore, does not direct the use of, and receive the benefit from, any work completed to date. Although the equipment is being manufactured for the customer, the entity could sell the equipment to another customer and manufacture additional equipment for transfer to the customer on December 31.

Consequently, the entity's performance obligation is to provide the customer with equipment because the customer does not control the equipment until its delivery.

IG67. The following example illustrates a continuous transfer of services.

Example 16—Consulting services

On January 1, an entity enters into a six-month fixed-price contract with a customer to analyze the customer's historical sales trends in order to assist the customer in developing its budget. The entity promises to share findings with the customer each month and to provide the customer with a final report at the end of the contract. The customer promises to pay \$10,000 per month. The customer can change the specification of its requirements throughout the contract and has the right to obtain any analysis prepared by the entity.

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer has the ability to direct the use of, and receive the benefit from, the consulting services as they are performed. The customer has an unconditional obligation to pay throughout the contract as evidenced by the nonrefundable progress payments. Additionally, the customer specifies the services to be provided throughout the contract and, hence, directs the nature of the services to be performed, which affects the entity's final report.

Consequently, the entity's performance obligation is to provide the customer with services continuously during the six months of the contract.

IG68. The following example illustrates a contract in which the entity promises to transfer a completed asset.

Example 17—Sale of apartments

An entity is developing residential real estate and begins to market individual apartments during their construction. An entity enters into a contract with a customer for the sale of a specific apartment. The customer pays a deposit that is refundable only if the entity fails to deliver the completed apartment in accordance with the contract. The remainder of the purchase price is paid on completion of the contract when the customer obtains possession of the apartment. The customer is able to choose from a range of standardized options specified by the entity (for example, flooring, color schemes, and fixtures).

Example 17—Sale of apartments (continued)

In this example, the terms of the contract and all the related facts and circumstances indicate that the customer obtains control of the apartment on completion of the contract. The customer obtains title and physical possession of the apartment only on completion of the contract. Additionally, the customer cannot specify major structural changes to the design of the apartment, which suggests that the apartment is not a customer-specific asset.

Consequently, the entity's performance obligation is to provide the customer with a completed apartment because the customer does not control the apartment until completion of the contract.

Customer acceptance

- IG69. Customer acceptance clauses are substantive contractual terms intended to ensure the customer's satisfaction with the goods or services promised in a contract. Without the customer's acceptance, the entity may not be entitled to consideration or may be required to take remedial action.
- IG70. An entity shall consider the effect of acceptance clauses in determining whether a customer has obtained control of a promised good or service.
- IG71. If an entity can objectively determine that a good or service has been transferred to the customer in accordance with the agreed specifications in the contract, then customer acceptance is a formality that would not affect an entity's determination of when the customer has obtained control of the good or service. For example, if the customer acceptance clause is based on meeting specified size and weight characteristics, an entity would be able to determine whether those criteria have been met before receiving the customer's acceptance. The entity's experience with contracts for similar goods or services may provide evidence that a good or service provided to the customer is in accordance with the agreed specifications in the contract. If revenue is recognized before customer acceptance, the entity must still consider whether there are any remaining performance obligations (for example, installation of equipment) and evaluate whether to account for them separately.
- IG72. If, however, an entity cannot objectively determine that the good or service provided to the customer is in accordance with the agreed specifications in the contract, then the entity would not be able to conclude that the customer has obtained control until the entity receives the customer's acceptance. That is because the entity cannot determine that the customer has the ability to direct the use of, and receive the

benefit from, the good or service. For example, suppose an entity enters into a contract to provide one of its products, modified so that it can be integrated into the customer's new production line, and the customer's acceptance in the contract is subject to the customer's judgment of whether that product has been satisfactorily integrated. Further suppose that the entity has never previously modified its equipment in that way. In that case, the customer's written acceptance indicates the point at which the customer obtains control of the product.

- IG73. In some contracts, the effect of the acceptance clause is that an entity has delivered products to the customer for trial or evaluation purposes without the customer committing to pay any consideration. In some of those cases, the customer is contractually required to accept the product if it does not return it by a specified date. Hence, in those contracts the product has not been transferred to the customer until either the customer accepts the product or the specified date passes.

Determining the transaction price (paragraphs 35–49)

- IG74. Paragraph 35 requires an entity to determine the transaction price. An entity shall consider the effects of the following when determining the transaction price:
- (a) variable consideration (paragraphs IG75–IG77);
 - (b) collectibility (paragraphs IG78–IG80);
 - (c) the time value of money (paragraphs IG81–IG84); and
 - (d) consideration payable to the customer (paragraph IG85).

Variable consideration

- IG75. Paragraph 38 states that an entity shall recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated.
- IG76. The following example illustrates a situation in which part of the total consideration amount cannot be reasonably estimated.

Example 18—Management fees based on an index

On January 1, an entity enters into a contract with a client to provide fund management services for one year. The customer is required to pay a fixed quarterly amount plus 10 percent of any increase in the fund's value relative to an observable index at the end of the year.

**Example 18—Management fees based on an index
(continued)**

The entity has entered into many similar contracts previously. However, the entity determines that its experience with those types of contracts is not relevant to the contract because the circumstances surrounding those types of contracts could change significantly. The variable consideration amount is highly susceptible to external factors (market risk), the uncertainty is not expected to be resolved until the end of the year, and the contract has a large number of possible consideration amounts.

Hence, the transaction price would be limited to the fixed amount of consideration until the end of the year.

- IG77. The following example illustrates a situation in which an entity has experience with similar types of contracts and that experience is relevant to the contract.

**Example 19—Consulting services with a performance
bonus/penalty**

A consultant enters into a contract and promises to provide cost management consulting services to a client over six months. The client promises to pay \$20,000 at the beginning of each month. At the end of the contract, the consultant either will give the client a refund of \$10,000 or will be entitled to an additional \$10,000, depending on the client's level of cost savings.

The consultant has extensive experience with similar types of contracts and that experience is relevant to the contract. The uncertainty will be resolved in a relatively short period of time, the contract does not have a large number of possible consideration amounts, and the consideration amount is not highly susceptible to external factors (that is, the amount is largely determined by the consultant's performance). Hence, at contract inception, the consultant estimates the transaction price by identifying the following possible consideration amounts and their related probabilities:

Example 19—Consulting services with a performance bonus/penalty (continued)

Possible consideration amounts	Probabilities	Expected consideration
\$130,000 ($\$20,000 \times 6 + \$10,000$)	80%	\$104,000
\$110,000 ($\$20,000 \times 6 - \$10,000$)	20%	<u>\$22,000</u>
Transaction price at contract inception		<u>\$126,000</u>

After three months, circumstances change and the consultant revises its estimates of the probabilities of the possible consideration amounts. Hence, the estimated transaction price changes as follows:

Possible consideration amounts	Probabilities	Expected consideration
\$130,000 ($\$20,000 \times 6 + \$10,000$)	60%	\$78,000
\$110,000 ($\$20,000 \times 6 - \$10,000$)	40%	<u>\$44,000</u>
Transaction price after three months		<u>\$122,000</u>

At the end of the contract, the consultant receives the additional consideration of \$10,000.

At contract inception, the consultant would allocate the transaction price of \$126,000 to the performance obligation to provide consulting services. Because those services are provided evenly over the 6 months, the consultant would recognize revenue of \$21,000 per month ($\$126,000 \div 6$ months).

Because the client pays \$20,000 per month (\$1,000 less than the revenue recognized), the consultant would recognize a contract asset of \$1,000 in the first month to reflect the revenue recognized in excess of its unconditional rights to consideration. That contract asset would increase to \$3,000 by the end of the third month.

Example 19—Consulting services with a performance bonus/penalty (continued)

After 3 months, the estimated transaction price decreases by \$4,000 (\$126,000 – \$122,000). Because half of the performance obligation has been satisfied (3 months ÷ 6 months), half of the \$4,000 decrease in the transaction price would be allocated to the satisfied performance obligation. Hence, the consultant would recognize revenue of \$61,000 for the first 3 months ($\$122,000 \times 3 \text{ months} \div 6 \text{ months}$). The contract asset and revenue would decrease by \$2,000 (half of the \$4,000 decrease in the transaction price) at the time of the change in estimate.

At the end of the contract, the transaction price becomes a fixed amount of \$130,000. Therefore, the consultant recognizes revenue of \$8,000 ($\$130,000 - \$122,000$).

If the consultant could not reasonably estimate the probability of each outcome during the contract, the transaction price would not include uncertain amounts. Hence, the transaction price would be \$110,000 until the uncertainty is resolved.

Collectibility

- IG78. In many contracts, the effect of the customer's credit risk on the transaction price is immaterial. In such cases, an entity measures the transaction price at the original invoice amount.
- IG79. However, in some contracts, although the contract satisfies the conditions in paragraph 10, there is a possibility that the customer might not pay the consideration for reasons other than the entity's nonperformance. That includes situations in which an entity enters into contracts with customers and expects a proportion of them to default, but does not know which specific customers will default. In such contracts, paragraph 43 requires the entity to reduce the amount of promised consideration to reflect the possibility that it will not receive some or all of the promised consideration. Hence, the transaction price shall reflect the probability-weighted amount of consideration the entity expects to receive from the customer. If such an amount cannot be reasonably estimated in accordance with paragraph 38, no revenue shall be recognized until either cash is collected or an amount can be reasonably estimated.

Example 20—Customer credit risk

An entity enters into a contract with a customer to provide goods for \$1,000. Payment is due one month after the goods are transferred to the customer.

The entity assesses, on the basis of its experience with contracts with similar characteristics, that there is a 10 percent chance that the customer will not pay the consideration. Hence, the transaction price is \$900 $[(90\% \times \$1,000) + (10\% \times \$0)]$. When the entity transfers the goods to the customer and satisfies its performance obligation, it recognizes a receivable and revenue of \$900.

After transferring the goods to the customer, the financial condition of the customer deteriorates and the entity determines that the receivable due from that customer is further impaired by \$60. The entity recognizes the impairment as an expense rather than as a reduction in revenue.

- IG80. If the entity enters into a group of similar contracts in which the promised consideration is required to be adjusted to reflect the customer's credit risk, the entity might recognize revenue on an individual contract basis in the amount of the invoiced amount. The entity would then adjust the initial measurement of the receivables and recognize a corresponding reduction of revenue for the group of contracts.

The time value of money

- IG81. Paragraph 44 requires an entity to adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component. In a contract with a material financing component, the amount of promised consideration comprises both of the following:
- (a) the cash selling price of the goods or services at the point that they are transferred to the customer (assuming there is no discount to the cash selling price agreed with the customer for any other reason); and
 - (b) a financing component, interest either to the customer or from the customer.
- IG82. An entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer. That rate would reflect the credit characteristics of the parties to the contract as well as any collateral or security provided by the customer or the entity,

which might include goods transferred in the contract. An entity may be able to determine that rate by identifying the rate that discounts the nominal amount of the promised consideration to the cash sales price of the good or service.

- IG83. The following example illustrates how an entity would adjust the amount of promised consideration when the customer pays in arrears.

Example 21—Customer payment in arrears

An entity sells a product to a customer for a \$10,000 payment due 2 years after the product is transferred to the customer. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 6 percent. When the entity transfers the product to the customer, it recognizes revenue of \$8,900 [$\$10,000 \div (1.06 \times 1.06)$]. The entity accounts for its unconditional rights to consideration (and interest) in accordance with the guidance on receivables in Topic 310.

- IG84. The following example illustrates how an entity would adjust the amount of promised consideration when the customer pays in advance.

Example 22—Customer payment in advance

An entity sells a product to a customer for a \$8,000 payment due 1 year before the product is transferred to the customer. On receipt of the customer's payment, the entity recognizes a contract liability of \$8,000. The entity determines that the discount rate in a financing transaction between the entity and the customer that did not involve the provision of other goods or services would be 10 percent. During the year before the product is transferred to the customer, the entity recognizes interest expense of, and increases the measurement of the performance obligation by, \$800 [$(\$8,000 \times 1.10) - \$8,000$]. Therefore, immediately before the performance obligation is satisfied, the carrying amount of the contract liability is \$8,800 ($\$8,000 + \800). The entity recognizes revenue of \$8,800 when it transfers the product to the customer.

Consideration payable to the customer

- IG85. When an entity pays consideration to the customer, paragraph 48 requires the entity to determine whether that consideration is a reduction of the transaction price, a payment for a distinct good or service, or a

combination of both. The following examples illustrate how an entity would make that determination.

Example 23—Slotting fees

An entity sells 1,000 units of a product to a reseller for \$10,000. In addition, the entity pays \$1,000 to the reseller in exchange for a product placement service. That service includes specified services of stocking, displaying, and supporting the products. The entity determines, on the basis of similar transactions in the marketplace, that the fair value of the product placement service is \$600.

The entity must assess whether the \$1,000 payment to the customer is a reduction of the transaction price, a payment in exchange for a distinct good or a service, or a combination of both.

Although the product placement service is not sold separately (that is, without related products), the service is distinct because it has a distinct function and a distinct profit margin. Hence, the payment to the reseller for the product placement service would result in the entity recognizing an expense in the amount of the fair value of the service (\$600). The remaining \$400 (\$1,000 payment to reseller – \$600 fair value of the service) would result in a reduction of the transaction price. The entity would recognize revenue of \$9,600 (\$10,000 – \$400) when the reseller obtains control of the products.

Example 24—Sales incentive

A manufacturer sells 1,000 units of a product to a retailer for \$8 per unit. The retailer sells the product directly to customers for \$10 per unit. The manufacturer issues coupons for a \$1 discount directly to customers via newspapers and flyers. The retailer accepts the coupons from customers and, thus, the customer pays \$10 per unit without a coupon or \$9 per unit with a coupon. The retailer submits all coupons to the manufacturer and receives \$1 per coupon submitted. At the time of transfer of products to the retailer, the manufacturer concludes that it cannot reasonably estimate the number of coupons to be redeemed.

Example 24—Sales incentive (continued)

The manufacturer receives no distinct good or service in exchange for the coupons. Because the manufacturer cannot reasonably estimate the number of coupons to be redeemed, the transaction price is \$7,000 (\$8,000 less maximum discount of \$1,000) in accordance with paragraphs 38–41. If the manufacturer issues the coupons before it transfers the products to the retailer, it would recognize revenue of \$7,000 when the products are transferred to the retailer (in accordance with paragraph 49).

Allocating the transaction price to separate performance obligations (paragraphs 50–53)

- IG86. Paragraph 50 requires an entity to allocate the transaction price to performance obligations in proportion to the standalone selling price (estimated if necessary) of the good or service underlying each of those performance obligations at contract inception. The following guidance illustrates how an entity would allocate the transaction price when an entity grants a customer an option to acquire additional goods or services that is determined to be a separate performance obligation as discussed in paragraphs IG24–IG26.
- IG87. The standalone selling price for a customer's option to acquire additional goods or services often is not directly observable and must be estimated. That estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for the following:
- (a) any discount that the customer could receive without exercising the option; and
 - (b) the likelihood that the option will be exercised.

Example 25—Estimating the standalone selling price of an option for additional goods or services

Consider again Example 5. The entity could estimate the standalone selling price of the discount voucher as follows.

The entity estimates an 80 percent likelihood that a customer will redeem the voucher and that a customer will, on average, purchase \$50 of additional products. Because the entity intends to offer a 10 percent discount to all customers as part of a seasonal promotion, the 40 percent discount that the customer would obtain when exercising the voucher needs to be reduced by 10 percentage points to 30 percent to reflect the incremental value of the discount to the customer.

Hence, the entity's estimated standalone selling price of the discount voucher is \$12 (\$50 average purchase of additional products × 30% incremental discount × 80% likelihood of exercising the option).

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

Example 26—Customer loyalty program

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

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

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

Product	\$91,324	$(\$100,000 \times \$100,000 \div \$109,500)$
Points	\$8,676	$(\$100,000 \times \$9,500 \div \$109,500)$

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

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

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

- IG88. If a customer has the option to acquire additional goods or services that provides it with a material right and those goods or services are:

- (a) similar to the original goods or services in the contract; and
- (b) provided in accordance with the terms of the original contract;

then an entity may, as a practical alternative to estimating the standalone selling price of the option, allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding expected consideration. Typically, those types of options are for contract renewals.

Example 27—Maintenance services with a renewal option

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

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

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

The entity expects 90 percent of customers to renew at the end of the first year and 90 percent of those customers to renew at the end of the second year.

The entity determines the amount to allocate to the option at the end of the first and second years as follows.

Example 27—Maintenance services with a renewal option (continued)

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

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

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

Expected costs adjusted for likelihood of contract renewal	Allocation of consideration expected
Year 1 \$ 600 ($\$600 \times 100\%$)	\$ 780 ($\$600 \div \$2,085 \times \$2,710$)
Year 2 \$ 675 ($\$750 \times 90\%$)	\$ 877 ($\$675 \div \$2,085 \times \$2,710$)
Year 3 \$ <u>810</u> ($\$1,000 \times 81\%$)	\$ <u>1,053</u> ($\$810 \div \$2,085 \times \$2,710$)
<u>\$2,085</u>	<u>\$2,710</u>

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

Contract costs (paragraphs 57–63)

- IG89. Paragraph 57 states that if the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another Topic (for example, inventory; property, plant and equipment; and capitalized software), an entity shall recognize an asset if specified criteria are met.

IG90. The following example illustrates how an entity would apply that guidance.

Example 28—Outsourcing services with set-up activities

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

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

The \$10,000 costs of obtaining the contract are recognized as expenses when incurred.

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

Design services	\$ 40,000
Hardware and software	\$210,000
Migration and testing of datacenter	<u>\$100,000</u>
Total	<u>\$350,000</u>

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

- (a) Hardware costs—accounted for in accordance with Topic 360;
- (b) Software costs—accounted for in accordance with Subtopic 350-40; and
- (c) Costs of the design, migration, and testing of the datacenter—these costs would be considered for capitalization in accordance with paragraph 57. Any resulting asset would be amortized as the entity provides the services outsourced by the customer.

Presentation (paragraphs 64–68)

IG91. Paragraph 64 specifies that when either party to a contract has performed, the entity shall recognize the contract either as a contract asset or as a contract liability. Paragraph 66 specifies that an entity shall present an unconditional right to consideration as a receivable. The following example illustrates those requirements.

Example 29—Presentation

In each of the following scenarios, the entity determines that the effects of the customer's credit risk and the time value of money are not material.

Scenario 1—receivable

On January 1, an entity enters into a contract to transfer a product to a customer on March 31. The contract requires the customer to pay the consideration of \$1,000 on April 30. The entity transfers the product on March 31.

On satisfying the performance obligation on March 31 and obtaining an unconditional right to consideration:

Dr receivable	\$1,000		
		Cr revenue	\$1,000

On receiving the cash:

Dr cash	\$1,000		
		Cr receivable	\$1,000

Scenario 2—contract liability and receivable

On January 1, an entity enters into a contract to transfer a product to a customer on March 31. The contract requires the customer to pay the consideration of \$1,000 in advance on January 31. The contract is noncancellable. The customer pays on February 15, and the entity transfers the product on March 31.

Example 29—Presentation (continued)

On obtaining an unconditional right to consideration on January 31:

Dr receivable	\$1,000	
Cr contract liability		\$1,000

On receiving the cash on February 15:

Dr cash	\$1,000	
Cr receivable		\$1,000

On satisfying the performance obligation on March 31:

Dr contract liability	\$1,000	
Cr revenue		\$1,000

If the contract were cancellable, the entity would not make the above accounting entry on January 31 because it would not have an unconditional right to consideration. Instead, it would recognize the cash and contract liability on February 15.

Scenario 3—contract asset and receivable

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

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

On satisfying the performance obligation to transfer Product X:

Dr contract asset	\$400	
Cr revenue		\$400

Example 29—Presentation (continued)

On satisfying the performance obligation to transfer Product Y:

Dr receivable	\$1,000	
Cr contract asset		\$400
Cr revenue		\$600

Disclosure (paragraphs 69–83)

- IG92. Paragraph 72 requires an entity to present and disclose information in a way that shows how that information relates to information provided in accordance with other Topics. The following example illustrates how an entity might comply with that requirement.

Example 30—Relationship to disclosures provided by other Topics

An entity has three operating segments that reflect geographical areas A, B, and C in accordance with Topic 280.

The entity decides that the information about the expected timing of satisfaction of remaining performance obligations required by paragraph 78 is best provided by showing it by type of customer as follows:

	Government	Nongovernment
Not later than one year	X	X
Later than one year but not later than two years	X	X
Later than two years but not later than three years	X	–
Later than three years	X	–
Total	X	X

The entity provides additional information to explain the relationship between this disclosure and that required by Topic 280 as follows:

Example 30—Relationship to disclosures provided by other Topics (continued)

Government contracts represent 65 percent and 25 percent of the revenues in Operating Segments A and C, respectively. There are no material government contracts in Operating Segment B.

- IG93. Paragraph 81 requires an entity to disclose information about the judgments, and changes in judgments, made in applying the proposed guidance. An entity shall provide both quantitative information and qualitative information to help users assess the potential effect of those judgments on revenue and cash flows from contracts with customers.
- IG94. The following example illustrates how an entity might disclose information about its judgments made in applying the proposed guidance.

Example 31—Inputs and assumptions used to estimate standalone selling prices

The entity's estimated standalone selling price for the software upgrade right included with Product X is \$100. The software upgrade right is specified in the contract but not sold separately. When estimating the standalone selling price of the software upgrade right, the entity considered the prices charged by the entity for upgrade rights provided with Product Y and the entity's historical pricing practices, including the relative selling prices of upgrades relative to the prices of the related products.

- IG95. In some cases, it may be relatively straightforward for an entity to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition.

IG96. In other cases, it may not be practicable to disclose quantitative information about the inputs and assumptions used and their effect on the amount and timing of revenue recognition because of the number of goods or services for which estimated prices are required. In those cases, an entity would describe its methods, inputs, assumptions, and estimates. That description might include the following:

- (a) the source of inputs (for example, observable market data, internally generated figures, or a mixture of the two);
- (b) how often the inputs and assumptions are updated and the date of the latest update; and
- (c) a description of how past experience and current conditions are taken into account in developing estimates and assumptions.

Approval by the Board

The proposed guidance was approved for publication by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

- BC1. This basis for conclusions summarizes the considerations of the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) in developing the proposed guidance for revenue from contracts with customers, including the reasons for proposing particular approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.
- BC2. This basis for conclusions discusses the following matters:
- (a) background (paragraphs BC3–BC8);
 - (b) scope (paragraphs BC9–BC26);
 - (c) recognition of revenue (paragraphs BC27–BC75);
 - (d) measurement of revenue (paragraphs BC76–BC129);
 - (e) onerous performance obligations (paragraphs BC130–BC148);
 - (f) contract costs (paragraphs BC149–BC158);
 - (g) presentation (paragraphs BC159–BC166);
 - (h) disclosure (paragraphs BC167–BC185);
 - (i) implementation guidance (paragraphs BC186–BC230);
 - (j) transition (paragraphs BC231–BC235);
 - (k) effective date and early adoption (paragraphs BC236–BC238);
 - (l) costs and benefits (paragraphs BC239–BC247); and
 - (m) consequential amendments (paragraphs BC248–BC252).

Background

- BC3. The FASB and the IASB initiated a joint project to improve the financial reporting of revenue under U.S. GAAP and IFRSs. The Boards decided that their existing requirements on revenue were in need of improvement because:
- (a) U.S. GAAP comprises broad revenue recognition concepts and numerous requirements for particular industries or transactions that can result in different accounting for economically similar transactions; and
 - (b) the two main revenue standards in IFRSs have different principles and can be difficult to understand and apply to

transactions beyond simple transactions. In addition, IFRSs have limited guidance on important topics such as revenue recognition for multiple-element arrangements.

- BC4. The Boards decided to eliminate those inconsistencies and weaknesses by developing a single revenue recognition model that would apply to a wide range of industries. The Boards concluded that this approach also would:
- (a) provide a more robust framework for addressing revenue recognition issues;
 - (b) improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets; and
 - (c) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.
- BC5. In December 2008, the Boards published for public comment the Discussion Paper, *Preliminary Views on Revenue Recognition in Contracts with Customers*. In that paper, the Boards proposed the general principles of a contract-based revenue recognition model with a measurement approach based on an allocation of the transaction price. The Boards received more than 200 comment letters in response.
- BC6. After publishing the Discussion Paper, the Boards continued to develop the proposed model. In November and December 2009, the Boards held workshops in London, Melbourne, Norwalk, and Tokyo to discuss the proposals with preparers from a wide range of industries. Members and staff of the Boards have also been consulting users and preparers across a wide range of industries and jurisdictions around the world. Auditors and securities regulators have also been consulted throughout the development of the proposed requirements.
- BC7. Most respondents have expressed support for the Boards' objective to improve the financial reporting of revenue. However, some respondents have questioned whether there is a need to replace existing standards on revenue recognition—in particular those requirements that seem to work reasonably well in practice and provide useful information about the different types of contracts for which they are intended.
- (a) For U.S. GAAP, some question whether a new revenue recognition model is necessary because Accounting Standards Update No. 2009-13, *Multiple-Deliverable Revenue Arrangements* (ASU 2009-13), has resolved some of the issues that the revenue recognition project set out to resolve. Furthermore, the *FASB Accounting Standards Codification*TM has simplified the process of accessing and researching existing requirements on revenue.

- (b) For IFRSs, some believe that the IASB could improve its existing standards by developing additional requirements on critical issues (for example, multiple-element arrangements) without replacing existing standards.
- BC8. The Boards acknowledge that it would be possible to improve many existing revenue recognition requirements without replacing them. However, the Boards think that, even after the recent changes to U.S. GAAP, the existing requirements in U.S. GAAP and IFRSs would continue to result in inconsistent accounting for revenue and, consequently, would not provide a robust framework for addressing revenue recognition issues in the future. Furthermore, amending existing requirements would fail to achieve one of the goals of the revenue recognition project—to develop a common revenue standard for U.S. GAAP and IFRSs that entities can apply consistently across industries, jurisdictions and capital markets. Because revenue is a crucial number to users of financial statements, the Boards think that having a common standard on revenue for U.S. GAAP and IFRSs is an important step towards achieving the goal of a single set of high quality global accounting standards.

Scope (paragraphs 6 and 7)

- BC9. Revenue, as defined in each of the Boards' conceptual frameworks, includes revenue arising from contracts with customers and revenue arising from other transactions or events. The proposed guidance would apply only to a subset of revenue—revenue from contracts with customers. The Boards had two reasons for developing a model that would apply only to contracts with customers. First, contracts to provide goods or services to customers are important economic phenomena and are the lifeblood of most entities. Secondly, most revenue recognition requirements in IFRSs and U.S. GAAP focus on contracts with customers. Because the Boards' objective is to develop a model that can replace most of the existing revenue requirements, that model needs to be at least as broad in scope as those requirements.
- BC10. Revenue that does not arise from a contract with a customer would not be affected by the proposed guidance. For example, in accordance with other standards, revenue would continue to be recognized from changes in the value of biological assets, investment properties, and the inventory of commodity broker traders, and from dividends.
- BC11. Some respondents to the Discussion Paper asked the Boards to clarify the existing definitions of revenue or develop a common definition of revenue. The Boards decided that the definition of revenue is a matter for consideration in their joint Conceptual Framework project. However, the

IASB decided to carry forward into its exposure draft the description of revenue from the IASB *Framework* rather than the definition of revenue from IAS 18. The IASB noted that the IAS 18 definition refers to “gross inflow of economic benefits” and the IASB had concerns that some may misread that reference as implying that an entity should recognize as revenue a prepayment from a customer for goods or services. As described in paragraphs BC27–BC34, revenue is recognized in accordance with the proposed guidance only as a result of an entity satisfying a performance obligation in a contract with a customer.

Contracts and customers (Appendix A)

BC12. The definitions of a *contract* and a *customer* establish the scope of the proposed guidance. The proposed guidance adopts the definitions of a contract and a customer that were proposed in the Discussion Paper. Respondents generally agreed with those definitions.

Definition of a contract

BC13. The definition of a contract is based on common legal definitions of a contract in the United States and is similar to the definition of a contract used in IAS 32, *Financial Instruments: Presentation*. Some respondents to the Discussion Paper suggested that the IASB should adopt a single definition of a contract for both IAS 32 and the proposed guidance. However, the IASB decided not to adopt the IAS 32 definition because that definition implies that contracts can include agreements that are not enforceable by law. Including such agreements would be inconsistent with the Boards’ proposal that an agreement must be enforceable by law for an entity to recognize the rights and obligations arising from that contract. The IASB also noted that amending the IAS 32 definition posed the risk of unintended consequences in accounting for financial instruments.

BC14. The definition of a contract emphasizes that a contract exists when an agreement between two or more parties creates enforceable obligations between those parties. The Boards noted that such an agreement does not need to be in writing to be a contract. Whether the agreed terms are written, oral, or evidenced otherwise, if the agreement creates obligations that are enforceable against the parties, it is a contract.

BC15. Some respondents requested additional guidance to clarify the meaning of *enforceable rights and obligations* in the definition of a contract. The Boards noted that whether a contractual right or obligation is enforceable is a question of law and the factors that determine enforceability may differ between jurisdictions. However, the Boards decided to specify (in paragraph 10) the attributes of a contract that must be present before an

entity would apply the proposed revenue requirements. Those attributes are derived mainly from existing requirements:

- (a) *The contract has commercial substance*—the Boards first considered this attribute of a contract when discussing whether revenue should be recognized for nonmonetary exchanges. Such transactions have been an area of financial reporting abuse in the past, with entities transferring goods or services back and forth to each other (often for little or no cash consideration), thereby artificially inflating their revenues. Therefore, the Boards concluded that an entity should not recognize revenue from a nonmonetary exchange if the exchange has no commercial substance. Because other types of contracts also could lack commercial substance, the Boards decided that all contracts should have that attribute before revenue can be recognized. The Boards considered existing guidance on commercial substance when describing it in terms of an entity's expectation of future cash flows changing as a result of the contract.
- (b) *The parties to the contract have approved the contract and are committed to satisfying their respective obligations*—if the parties to a contract have not approved the contract, it is questionable whether the contract is enforceable. In addition, the Boards thought this requirement would be useful when there is significant doubt about the collectibility of consideration from the customer. In some cases, that doubt indicates that the parties are not committed to the contract and that the entity does not have an enforceable right to consideration. If the entity does have an enforceable right, then uncertainty about the collectibility of consideration would generally be reflected in the measurement of revenue.
- (c) *The entity can identify each party's enforceable rights regarding the goods or services to be transferred*—the Boards decided that an entity would not be able to assess the transfer of goods or services if the entity cannot identify each party's enforceable rights regarding those goods or services.
- (d) *The entity can identify the terms and manner of payment for those goods or services*—the Boards decided that an entity would not be able to determine the transaction price if the entity cannot identify the terms and manner of payment in exchange for the promised goods or services.

Definition of a customer

BC16. The purpose of defining a customer is to distinguish a revenue contract within the scope of the proposed guidance from other contracts into

which an entity enters. Some respondents asked the Boards to clarify the meaning of *ordinary activities* in the definition of a customer. However, that notion was derived from the existing definitions of revenue. As noted in paragraph BC11, the Boards are not reconsidering those definitions in the revenue project.

BC17. When considering the definition of a customer, the Boards observed that revenue could be recognized from transactions with partners or participants in a collaborative arrangement. Those arrangements would be within the scope of the proposed guidance only if the other party to the arrangement meets the definition of a customer. Some industry respondents asked the Boards to clarify whether common types of arrangements in their industries would meet the definition of a contract with a customer. However, the terms and conditions of a specific arrangement may determine the assessment of whether the parties to the arrangement have a supplier-customer relationship or some other relationship (for example, as collaborators or as partners). Therefore, the Boards decided that it would not be possible to develop application guidance that would apply uniformly to various industries. An entity would need to consider all relevant facts and circumstances in assessing whether the counterparty meets the definition of a customer. Examples of arrangements in which an entity may need to make such an assessment include:

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

Contracts outside the scope of the proposed guidance (paragraph 6)

BC18. The Boards decided to exclude from the scope of the proposed guidance three types of contracts with customers that the Boards are addressing in other standard-setting projects:

- (a) leases;
- (b) insurance contracts; and
- (c) financial instruments and other contracts within the scope of the financial instruments standards.

That decision is consistent with the proposals in the Discussion Paper, which were supported by most respondents.

- BC19. The FASB also decided to exclude from the scope of the proposed guidance guarantees (other than product warranties) that are within the scope of Topic 460 on guarantees. The focus of the existing accounting requirements for those guarantee arrangements relates primarily to recognizing and measuring a guarantee liability.
- BC20. Some respondents have reasoned that excluding some contracts with customers from the scope of the proposed guidance could perpetuate the development of industry-specific or transaction-specific revenue requirements, which would be inconsistent with the revenue recognition project's stated objective. The Boards disagreed. The proposed guidance provides the Boards with a framework for considering revenue issues in other standard-setting projects. Any departure from the proposed guidance in those projects would arise from a decision by the Boards that a different basis of accounting for those contracts with customers would provide users of financial statements with more useful information.
- BC21. Many respondents expressed concerns with how the proposed revenue recognition model would apply to construction-type contracts and asked the Boards to retain existing requirements for those contracts. After discussing those concerns with various preparers from the construction industry, the Boards concluded that this response was in part attributable to a misperception that the proposed model would require completed contract accounting for all contracts currently within the scope of Subtopic 605-35 on construction-type and production-type contracts or IAS 11. As discussed below, with the proposed guidance, the Boards have clarified that not all construction contracts would result in an entity recognizing revenue only at contract completion. The Boards concluded that there were no reasons to apply a different revenue recognition model to construction contracts; revenue from a construction contract should be recognized as the entity transfers goods or services to the customer. Hence, the Boards affirmed the proposal in the Discussion Paper that the proposed guidance would apply to construction contracts.

Contracts partially within the scope of other standards (paragraph 7)

- BC22. Some contracts with customers would be partially within the scope of the proposed guidance and partially within the scope of other standards (for example, a lease with a distinct service). In those cases, the Boards decided it would not be appropriate for an entity to account for the entire contract in accordance with one or the other standard. If that were possible, different accounting outcomes could result depending on whether the goods or services were sold on a standalone basis or together with other goods or services.

- BC23. The Boards think that the proposed guidance should be the default approach for separating a contract and allocating consideration to each part. However, specific issues could arise in separating contracts that are not within the scope of the proposed guidance. For example, a financial instrument or an insurance contract might require an entity to provide services that are best accounted for in accordance with the standards on financial instruments or insurance contracts.
- BC24. Therefore, the Boards decided that if other standards specify how to separate and/or initially measure parts of a contract, an entity should first apply those requirements. Under that approach, which is consistent with the guidance on multiple-element arrangements in Subtopic 605-25, the more specific standard would take precedence in accounting for a component of a contract. The Boards are not aware of any practice issues that would justify a departure from the approach in Subtopic 605-25. The Boards have simplified and condensed the requirements in Subtopic 605-25 because the proposed guidance would replace some of the specific revenue recognition requirements in U.S. GAAP (for example, for software and construction-type contracts) that otherwise would need to be considered when assessing scope.

Exchanges of products to facilitate a sale to another party (paragraph 6(e))

- BC25. In industries with homogeneous products, it is common for entities in the same line of business to exchange products to facilitate sales to customers other than the parties to the exchange. An example is when an oil supplier swaps inventory with another oil supplier to reduce transport costs, meet immediate inventory needs, or otherwise facilitate the sale of oil to the end customer. The Boards noted that a party exchanging inventory with an entity would meet the Boards' definition of a customer because it has contracted with the entity to obtain an output of the entity's ordinary activities. As a consequence, an entity might (in the absence of specific requirements) recognize revenue once for the exchange of inventory and then again for the sale of the inventory to the end customer. The Boards concluded that outcome would be inappropriate because:
- (a) it would gross up revenues and expenses and make it difficult for users to assess the entity's performance and gross margins during the reporting period; and
 - (b) some view the counterparty in those arrangements as a supplier and not as a customer.
- BC26. The Boards considered modifying the definition of a customer. However, they rejected that alternative because of concerns about unintended consequences. Therefore, the Boards propose to exclude from the scope

of the proposed guidance transactions involving nonmonetary exchanges between entities in the same line of business to facilitate sales to customers other than the parties to the exchange.

Recognition of revenue (paragraphs 8–33)

Contract-based revenue recognition principle

- BC27. In the Discussion Paper, the Boards proposed a principle to recognize revenue based on the accounting for the asset or liability arising from a contract with a customer. The Boards concluded that focusing on the recognition and measurement of that asset or liability, and the changes in that asset or liability over the life of the contract, would bring discipline to the earnings process approach. Consequently, it would result in entities recognizing revenue more consistently than when applying existing standards.
- BC28. On entering into a contract with a customer, an entity obtains rights to receive consideration from the customer and assumes obligations to transfer goods or services to the customer (performance obligations). The combination of those rights and performance obligations gives rise to an asset or liability depending on the relationship between the remaining rights and performance obligations. If the measure of the remaining rights exceeds the measure of the remaining performance obligations, the contract is an asset (a contract asset). Conversely, if the measure of the remaining performance obligations exceeds the measure of the remaining rights, the contract is a liability (a contract liability).
- BC29. By definition, revenue from a contract with a customer cannot be recognized until a contract exists. Revenue recognition could, in concept, arise at the point at which an entity enters into a contract with a customer. For an entity to recognize revenue at contract inception (that is, before either party has performed), the measure of the entity's rights must exceed the measure of the entity's performance obligations. That would lead to revenue recognition because of an increase in a contract asset. However, as discussed in paragraphs BC76–BC78, the Boards proposed in the Discussion Paper that performance obligations should be measured at the same amount as the rights in the contract, thereby precluding the recognition of a contract asset and revenue at contract inception.
- BC30. Hence, in the Discussion Paper, the Boards proposed that revenue should be recognized only when an entity transfers a promised good or service to a customer, thereby satisfying a performance obligation in the contract. That transfer results in revenue recognition because on satisfying a performance obligation, an entity no longer has that

obligation to provide the good or service. Consequently, its position in the contract increases—either its contract asset increases or its contract liability decreases—and that increase leads to revenue recognition.

- BC31. Although in concept revenue arises from an increase in a contract asset or a decrease in a contract liability, the Boards have articulated the proposed guidance in terms of recognition and measurement of revenue rather than recognition and measurement of the contract. The Boards thought that focusing on the timing and amount of revenue would simplify the articulation of the proposed guidance. Feedback from respondents to the Discussion Paper and others confirmed that view.
- BC32. Nearly all respondents to the Discussion Paper agreed with the Boards' view that, in general, an entity should not recognize revenue in the absence of a contract with a customer. Once a contract exists, however, some respondents supported an activities model in which revenue would be recognized when the entity undertakes activities to fulfill a contract, regardless of whether those activities result in the transfer of goods or services to the customer (that is, regardless of whether a performance obligation is satisfied). Those respondents reasoned that recognizing revenue continuously throughout long-term construction or other service contracts, regardless of whether goods or services are transferred to the customer, would provide users of financial statements with more useful information.
- BC33. However, the Boards noted the following concerns with an activities model:
- (a) revenue recognition would not be based on accounting for the contract—in an activities model, revenue arises from increases in the entity's assets, such as inventory or work in process, rather than from the contract. Therefore, conceptually, an activities model does not require a contract with a customer for revenue recognition, although revenue recognition could be deferred until a contract exists. However, that would result in revenue being recognized at contract inception for any activities completed to that point.
 - (b) it would be counterintuitive to many users of financial statements—an entity would recognize consideration as revenue when the customer has not received any promised goods or services in exchange.
 - (c) there would be potential for abuse—an entity could accelerate revenue recognition by increasing its activities (for example, production of inventory) at the end of a reporting period.
 - (d) it would result in a significant change to existing standards and practices—in many of those standards, revenue is recognized only when goods or services are transferred to the customer. For

example, in IAS 18, revenue from the sale of a good is recognized when the entity has transferred the ownership of the good to the customer. The Boards also observed that the principle of percentage of completion accounting in existing standards can also be consistent with the proposed revenue recognition principle in many cases. Paragraph 22 of AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (Subtopic 605-35) states that the basis for percentage of completion is that “the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses.”

- BC34. Accordingly, the Boards did not develop an activities model and maintained their preliminary view that a contract-based revenue recognition principle would be the most appropriate principle for a general revenue recognition standard for contracts with customers.

Combination and segmentation of contracts (paragraphs 12–16)

- BC35. The Discussion Paper assumed that an entity would apply the requirements of the proposed revenue recognition model to a single contract with a customer. That assumption is appropriate in most cases. However, in subsequent discussion, the Boards observed that the pattern of revenue recognition from a contract might vary depending on whether an entity applies the proposed guidance to a contract on a standalone basis, to a contract together with other contracts, or to separate parts of a single contract.
- BC36. The Boards considered the requirements in existing standards (for example, Subtopic 605-25, Subtopic 605-35, IAS 11, and IAS 18) on combining contracts and concluded that the criteria and terminology reflect a consistent underlying principle for combining contracts: namely, an entity should combine two or more contracts and account for them as a single contract if their prices are interdependent. The Boards decided to provide indicators of when contracts have interdependent prices. Those indicators are similar to those in existing standards.
- BC37. The principle for combining contracts has an implication for segmenting a contract: an entity should segment a single contract with a customer and account for it as two or more contracts if the prices of some goods or services to be transferred to the customer are independent of the prices of other goods or services.

BC38. During consultations following publication of the Discussion Paper, some preparers of financial statements questioned the need for a contract segmentation principle in addition to the requirements for identifying separate performance obligations in a contract (discussed in paragraphs BC45–BC59). The Boards decided that a segmentation principle was needed to:

- (a) simplify the assessment of scope—if some goods or services in the contract are priced independently and are within the scope of other standards, the contract segmentation principle would require an entity to segment the contract and account for each of the resulting identified contracts in accordance with the relevant standard; and
- (b) determine the promised goods or services to which an entity should allocate proportions of the transaction price—if a contract has a variable transaction price, the proposals require an entity to allocate changes in the transaction price to all performance obligations in the contract. If the prices of some goods or services are independent, an entity would account for the goods or services (and the corresponding transaction price) as a separate contract. Hence, the entity would not allocate changes in the transaction price of one bundle of performance obligations identified as a contract to another bundle of performance obligations identified as another contract.

Contract modifications (paragraphs 17–19)

BC39. When a contract is modified, an entity would be required to determine whether the modification amends the existing contract or creates an additional contract.

BC40. The Boards decided that the principle for combining and segmenting contracts should also determine how to account for a contract modification. That principle would ensure similar accounting for similar rights and obligations, regardless of the form of a contract. The Boards also decided that a contract modification must meet the same criteria specified in paragraph 10 for determining whether a contract exists for the purposes of applying the proposed revenue recognition requirements. The Boards concluded that it would be inappropriate for an entity to recognize revenue unless the entity has satisfied a performance obligation and a right to consideration exists (even if the measurement of the right is uncertain).

BC41. If the price of a contract modification is interdependent with the price of the existing contract, the Boards decided that the entity should, at the time of the modification, recognize the cumulative effects of that modification on the original contract. Otherwise, an entity might account

for similar rights and obligations differently depending on how the contract was structured and whether the contract's terms and conditions were negotiated at contract inception or renegotiated during the life of the contract. The Boards' decision on allocating the updated transaction price arising from a contract modification is consistent with their views on accounting for subsequent changes in transaction price as discussed in paragraph BC87.

Identifying separate performance obligations (paragraphs 20–24)

Definition of a performance obligation

- BC42. In the Discussion Paper, the Boards distinguished obligations to provide goods or services to a customer from other obligations by describing them as performance obligations. Performance obligations are similar to the notions of deliverables, components, or elements of a contract in existing standards. Although the notion of a performance obligation is implicit in many existing standards, the term *performance obligation* has not been defined and, hence, the Boards proposed a definition in the Discussion Paper. Respondents generally agreed with the Boards' proposed definition. Therefore, the Boards have used that definition in the proposed guidance with minor modification.
- BC43. Some respondents to the Discussion Paper argued that some promises to provide goods or services, although meeting the definition of a performance obligation, should be accounted for as marketing expenses. Examples include “free” handsets given by telecommunication entities as an incentive for customers to enter into service contracts and customer loyalty points awarded by supermarkets, airlines, and hotels. Those respondents reasoned that revenue should be recognized only for the main goods or services that the customer is seeking to acquire.
- BC44. The Boards concluded that all goods or services provided to a customer as a result of a contract give rise to performance obligations in that contract because they are part of the negotiated exchange between the entity and its customer. Although the entity might characterize those goods or services as marketing incentives, they are goods or services provided in the contract for which the customer pays. In contrast, marketing incentives are incurred independently of the contract that they are designed to secure. The Boards also noted that even if a conceptual justification could be found to distinguish goods or services that are marketing incentives from those that give rise to performance obligations, it would be difficult to develop criteria to make that distinction in practice.

Distinct goods or services

- BC45. Contracts with customers can contain many performance obligations. In the Discussion Paper, the Boards proposed that an entity should refer to the timing of transfer of the promised goods or services to identify the performance obligations that should be accounted for separately. Although many respondents to the Discussion Paper agreed with that principle, some respondents were concerned that applying that principle would not be practical when goods or services are transferred continuously because an entity would need to estimate a standalone selling price for numerous goods or services. The Boards agreed and decided to clarify how an entity should identify separate performance obligations.
- BC46. Respondents to the Discussion Paper and participants at the Boards' workshops had mixed views on determining whether to account for a promise of a good or service as a separate performance obligation. Representatives from the construction industry preferred to account for all the promised goods or services in a contract as a single performance obligation unless a part of the contract is regularly sold separately. Otherwise, they thought that the proposed revenue recognition model would not be practical and would not provide useful information to users of financial statements who, they believe, are more interested in the total contract profit margin than in the revenue and profit margin of an individual good or service in the contract.
- BC47. In contrast, representatives from other industries (for example, the technology industry) preferred to account for an individual good or service as a separate performance obligation even if it is not sold separately. Those representatives thought that to do otherwise would result in an entity's financial statements not providing users with useful information about revenue and profit margins as the entity transfers goods or services to customers.
- BC48. Consequently, when considering how entities across various industries should identify separate performance obligations, the Boards' objective was to develop requirements that would result in an entity recognizing revenue and profit margins in a manner that faithfully depicts the transfer of goods or services to the customer and that would be practical. To achieve that objective, the Boards decided that an entity should account for a promise of a good or service as a separate performance obligation only if that good or service is distinct.
- BC49. The best evidence that a good or service is distinct is when the good or service is sold separately. If a good or service is not sold separately, the Boards decided that an entity should account for the promised good or service as a separate performance obligation only if it could be sold

separately. In the absence of additional guidance, it would be difficult and highly subjective to assess whether a good or service could be sold separately. Part of that difficulty stems from the fact that, in theory, almost anything could be sold separately. Hence, for the purposes of revenue recognition, the Boards decided to provide additional guidance on whether an entity could sell a good or service separately and, therefore, should account for that promised good or service as a separate performance obligation. The Boards decided to require a promised good or service to have a distinct function and a distinct profit margin.

Distinct function

- BC50. A good or service has a distinct function if it has utility either on its own or together with other goods or services. A good or service with utility on its own is an asset that, on its own, can be consumed, disposed of, held, or otherwise used in a way that generates economic benefits. Even if a good or service does not have utility on its own, it nevertheless would be a distinct asset if it has utility together with other goods or services—either goods or services that the customer has acquired from the entity or goods or services that are sold separately by the entity or by another entity.
- BC51. If a good or service does not have a distinct function, it is questionable whether it is an asset. Hence, the Boards thought that requiring a good or service to have a distinct function would emphasize that an entity can have a performance obligation only for contractual promises that, when fulfilled, result in the transfer of an asset to the customer.
- BC52. The Boards noted that requiring a distinct function is consistent with the guidance on multiple-element arrangements in Subtopic 605-25, which requires a delivered item to have “value to the customer on a standalone basis” in order for an entity to account for that item separately. However, the Boards decided against using that terminology because it could suggest that an entity must identify performance obligations on the basis of its assessment of the customer’s intended use of the promised goods or services (which would affect the “value to the customer”). It would be difficult, if not impossible, for an entity to know the customer’s intentions in any given contract.

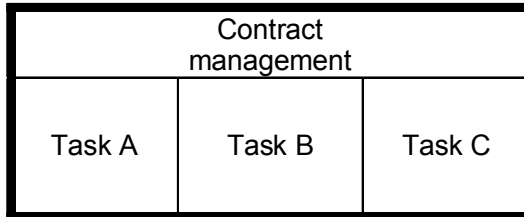
Distinct profit margin

- BC53. Even if a good or service has a distinct function, the Boards decided that it should be accounted for as separate performance obligation only if it also has a distinct profit margin. If a good or service does not have a

distinct profit margin, the Boards were concerned that requiring an entity to estimate a selling price for that good or service might result in information that would not be useful to users of financial statements.

- BC54. The proposed requirement of a *distinct profit margin* is similar to the guidance on construction-type contracts in Subtopic 605-35 that results in an entity accounting for elements of a contract separately only if each has a different rate of profitability.
- BC55. When a good or service is sold separately, the profit margin clearly is distinct and could be determined by subtracting the costs of the good or service from its standalone selling price. When a good or service is not sold separately, its selling price is not observable, which can make it more difficult for an entity to determine whether it has a distinct profit margin. In the absence of an observable selling price, the Boards' view is that an entity would have sufficient basis for estimating a selling price only if the good or service is subject to distinct risks and the entity can separately identify the resources needed to provide the good or service. Otherwise, the entity typically would not sell a good or service separately—not because it lacks a distinct function, but because the entity would lack a basis for determining the price at which it would sell the good or service separately.
- BC56. In some contracts, a good or service would not have a distinct profit margin because it is not subject to distinct risks. For example, in some construction contracts, the contractor provides a significant contract management service in addition to providing, or subcontracting for, the individual construction tasks. That contract management service is provided because some of the individual construction tasks are highly interrelated, requiring the contractor to manage and coordinate the various tasks. Moreover, if the contractor employed subcontractors, the contract management service might also cover the risk that the tasks performed by the subcontractors are not in accordance with the contract specifications and do not combine with other services to provide the integrated construction services for which the customer contracted. The relationship between the contract management service and the individual construction tasks can be illustrated as follows:

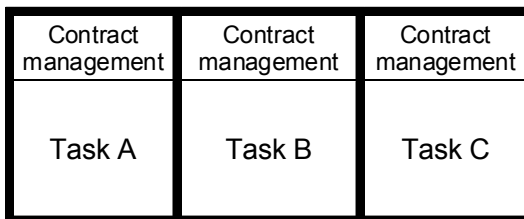
Diagram 1 – Contract with one separate performance obligation



BC57. Diagram 1 above illustrates a contract consisting of three tasks that are sold separately (each could be performed by a subcontractor). However, Tasks A, B, and C are highly related, thus requiring the entity to provide a significant contract management service to the customer that is associated with all of those tasks. Because the contract management service provided in conjunction with Tasks A, B, and C is subject to the same risks as the underlying, related construction tasks, the contract management service does not have a distinct profit margin. Hence, the contractor would be required to combine that service with the tasks with inseparable risks (Tasks A, B, and C) and account for all those promised goods or services as a single performance obligation.

BC58. In other contracts, the risks of the contract management service are either immaterial or they are attributable to specific tasks. In those contracts, the contract management service still would not have a distinct profit margin. However, the contractor would be able to combine a part of that service with a specific task. Hence, the entity would account for each task and part of the contract management service as a separate performance obligation. This is illustrated below in Diagram 2.

Diagram 2 – Contract with three separate performance obligations



BC59. The Boards also decided that the resources required to provide a good or service must be distinguishable for an entity to account for the good or service as a separate performance obligation. If the resources needed to

provide a good or service cannot be identified separately, the Boards concluded that the profit margin of the good or service would not be distinct. Hence, the entity would not have a basis for estimating a selling price for that good or service and the entity should not account for that promised good or service as a separate performance obligation.

Satisfaction of performance obligations (paragraphs 25–33)

Control (paragraphs 25–31)

BC60. Assessing the transfer of a good or service is critical to the proposed revenue recognition model because it determines when an entity satisfies a performance obligation and, hence, recognizes revenue. Most existing revenue standards require an entity to assess the transfer of an asset by considering the risks and rewards of ownership of the asset. However, the Boards decided that an entity should assess whether a transfer of an asset has occurred by considering whether the customer obtains control, for the following reasons:

- (a) the Boards' existing definitions of an asset use control to determine when an entity should recognize or derecognize an asset. Because the proposed guidance can be viewed as an asset derecognition model, the Boards decided to rely on the existing definitions of an asset.
- (b) a focus on control rather than risks and rewards should result in more consistent decisions about when goods or services are transferred. It can be difficult for an entity to judge whether a preponderance (or some other balance) of the risks and rewards of ownership of a good or service has been transferred to the customer if the entity retains some risks and rewards. Consequently, a risks and rewards approach for determining the transfer of goods or services can result in different accounting for economically similar contracts.
- (c) a risks and rewards approach could conflict with identifying separate performance obligations. For example, if an entity transfers a product to a customer but retains some risks associated with that product, an assessment based on risks and rewards might result in the entity identifying a single performance obligation that could be satisfied only after the risks are eliminated. However, an assessment based on control might appropriately identify two performance obligations—one for the product and another for a remaining service such as a fixed-price maintenance agreement. Those performance obligations would be satisfied at different times.

- BC61. Respondents to the Discussion Paper generally supported control as the basis for determining the transfer of goods or services. However, nearly all respondents asked the Boards to clarify what control of a good or service is and how an entity would determine when control has transferred to the customer.
- BC62. In light of those responses, the Boards have specified in the proposed guidance that control of a good or service refers to the ability to direct the use of, and receive the benefit from, a good or service. This definition is based on the meaning of control in the asset definitions in the Boards' respective conceptual frameworks. In developing that definition, the Boards decided that the definition of control (of a good or service) should include the following components:
- (a) *ability*—a customer must have the *present* right to direct the use of, and receive the benefit from, a good or service for an entity to recognize revenue. For example, in a contract that requires a manufacturer to produce an asset for a particular customer, it might be clear that the customer will ultimately have the right to direct the use of, and benefit from, the asset. However, the entity should not recognize revenue until the customer has obtained that right (which might occur during production or after, depending on the contract).
 - (b) *to direct the use of*—a customer's ability to direct the use of a good or service refers to the customer's right to deploy that asset in its activities, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that asset. The source of that right in the context of revenue recognition typically is an enforceable right as a consequence of a contract.
 - (c) *to receive the benefit from*—the customer must have the ability to receive the economic benefit from a good or service for the customer to obtain control of it. In concept, the economic benefit from a good or service is a potential cash flow (either an increase in cash inflows or a decrease in cash outflows). An entity can obtain the benefit directly or indirectly in many ways such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.
- BC63. The definition of *control* could be applied from the perspective of either the entity selling the good or service or the customer purchasing that good or service. Consequently, revenue could be recognized when the entity surrenders control of a good or service or when the customer obtains control of that good or service. Although, in many cases, both perspectives are likely to lead to the same result, the Boards have articulated the proposed indicators of control from the perspective of the customer. That perspective would minimize the risk of an entity

recognizing revenue from undertaking activities that do not coincide with the transfer of goods or services to the customer.

- BC64. Respondents to the Discussion Paper were most concerned about the application of the control guidance to contracts in the construction industry currently accounted for using a percentage-of-completion method of revenue recognition. Many respondents thought the proposals in the Discussion Paper could result in revenue recognition for construction contracts only upon transfer of legal title or physical possession of the finished asset, which often is upon contract completion. Because those contracts can take many years to complete, respondents thought that users of financial statements would be deprived of useful information unless revenue is recognized throughout the contract.
- BC65. The Boards did not intend that revenue should be recognized only upon contract completion. Nonetheless, the intention was that an entity would recognize revenue only when the customer receives promised goods or services and not necessarily as the entity undertakes activities to fulfill the contract. In the case of a construction contract, the customer receives the promised goods or services during construction only if the customer controls the work in process. In contrast, if the customer does not receive the goods or services until the work is completed, the entity would not recognize revenue until then.
- BC66. The Boards think that applying the proposed definition of control and the proposed indicators of control to a construction contract would be consistent with the requirements currently contained in IFRIC 15, *Agreements for the Construction of Real Estate*, for determining when a customer continuously obtains control of a promised asset.

Repurchase agreements (paragraphs IG47–IG53)

- BC67. When developing the proposed requirements on control, the Boards considered how an entity would apply the proposed guidance to contracts in which an entity sells an asset and also enters into a repurchase agreement (either in the same contract or in another contract).
- BC68. If the entity has an unconditional obligation or right to repurchase an asset (that is, a forward or call option), the Boards concluded that the customer does not obtain control of the asset and, therefore, no revenue is recognized. That is because the customer is constrained in its ability to direct the use of, and receive the benefit from, the asset. Because the customer is obliged to return, or to stand ready to return, the asset to the entity, the customer cannot use up or consume the entire asset. Moreover, the customer cannot sell the asset to another party (unless

that sale is subject to a repurchase agreement, in which case the customer's benefit from the sale is constrained).

- BC69. In theory, the customer is not constrained in its ability to direct the use of, and receive the benefit from, the asset if the entity agrees to repurchase, at the prevailing market price, an asset from the customer that is substantially the same and is readily available in the marketplace. However, the Boards noted that an entity would be unlikely to enter into such a transaction.
- BC70. If the customer has an unconditional right to require the entity to repurchase an asset (that is, a put option), the Boards concluded that the customer does obtain control of the asset. That is because the customer is neither obliged to return the asset nor obliged to stand ready to do so. Therefore, the customer has the ability to direct the use of, and receive the benefit from, the asset—it can sell, use up, or consume the entire asset and choose not to exercise the put option.
- BC71. If the customer has an unconditional right to require the entity to repurchase an asset, the Boards concluded that the entity should account for its obligation to stand ready to repurchase the asset. That is consistent with the proposed accounting for the sale of a product with a right of return (see paragraphs BC187–BC194), which results in the entity recognizing:
- (a) a liability for its obligation to repurchase the asset measured at the amount of the expected (probability-weighted) consideration to be paid to the customer; and
 - (b) an asset for the entity's right to receive the asset upon settling that liability.
- BC72. Some argue that, in some contracts, the terms of the put option and the surrounding facts and circumstances economically constrain the customer so that the customer neither directs the use of, nor receives the benefit from, the asset. Although the customer is not obliged to exercise its put option, the customer could incur a loss if it did not exercise its right. Hence, they reason that in such contracts the customer does not obtain control of the asset and that, economically, the transaction is similar to a forward contract. However, the Boards noted that if a customer is virtually certain to exercise its put option and receive a full refund, accounting for the put consistently with a right of return would result in recognizing assets and liabilities similar to those that would be recognized if the contract were accounted for as a forward contract. In addition, virtually no revenue would be recognized at the point of sale. Therefore, the Boards concluded that it would be preferable to deal with the likelihood of the customer exercising a put option through the measurement of the consideration allocated to the performance obligation to transfer the asset and to the liability to repurchase the asset,

rather than by developing criteria to specify when a put option should be accounted for similarly to a forward contract.

Continuous transfer of goods or services (paragraphs 32 and 33)

- BC73. Some performance obligations, when satisfied, result in the transfer of a good or service to the customer at a point in time. Other performance obligations result in the transfer of goods or services to the customer continuously over a period of time. Examples of the latter include product maintenance services and construction services. To recognize revenue in those cases, an entity must determine the amount of performance obligations satisfied during each reporting period—that is, the entity must measure its performance.
- BC74. The proposed guidance specifies that an entity should select a revenue recognition method that best depicts the entity's performance under the contract. The definition of performance in the proposed model is not flexible—an entity performs only when it transfers goods or services to a customer. However, the proposed requirements for measuring performance cannot be too rigid if they are to be applied across various industries and transactions. In principle, the Boards expect that methods based on outputs (for example, surveys of work performed) to the customer would provide the best depiction because they directly measure some attribute of the goods or services transferred to the customer. However, the Boards acknowledged that output methods may not always be practical if, for instance, the output to the customer is not directly observable or if the output cannot be measured reliably in a cost-effective manner.
- BC75. The Boards decided that an entity must select a method to measure performance for each separate performance obligation and must use that method consistently for that performance obligation and also across contracts that have performance obligations with similar characteristics. The Boards do not want an entity to use different methods to measure its performance in satisfying the same or similar performance obligations because that could reduce the comparability of information for users of financial statements. Moreover, if an entity were to change how it measures performance throughout a contract, it would effectively bypass the requirements for segmenting a contract and identifying separate performance obligations.

Measurement of revenue (paragraphs 34–53)

BC76. In the Discussion Paper, the Boards proposed an allocated transaction price approach to measure performance obligations. Under that approach, an entity would allocate the transaction price to each performance obligation on the basis of the relative standalone selling price of the good or service underlying that performance obligation.

BC77. The Discussion Paper also described an alternative approach whereby an entity would measure performance obligations directly at current exit price. The main reasons for rejecting that approach were:

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

BC78. Nearly all respondents to the Discussion Paper agreed with the Boards' preference for the proposed allocated transaction price approach over the alternative current exit price approach.

Determining the transaction price (paragraphs 35–49)

BC79. The proposed requirements specify that an entity should initially measure its rights and performance obligations at the transaction price—that is, the amount of consideration that the entity receives, or expects to receive, from the customer. The Discussion Paper assumed that the customer promised to pay a fixed amount of cash consideration that did not need to be adjusted to reflect the customer's credit risk or the time value of money. Therefore, after publishing the Discussion Paper, the Boards considered how an entity would determine the transaction price when the promised consideration is:

- (a) variable in amount (paragraphs BC80–BC95);
- (b) uncertain to be collected because of the risk that the customer might not be able to pay (paragraphs BC96–BC101);

- (c) paid at a time different from when the entity provides goods or services (paragraphs BC102–BC105); or
- (d) in a form other than cash (paragraphs BC106 and BC107).

Variable consideration

BC80. The Boards considered the following questions when developing the proposed guidance for contracts in which a customer promises consideration that is variable in amount:

- (a) how to define the transaction price (paragraphs BC81–BC83);
- (b) how to account for subsequent changes in the transaction price (paragraphs BC84–BC89); and
- (c) whether and how to constrain the transaction price (paragraphs BC90–BC95).

Definition of the transaction price

BC81. The Boards decided to define the *transaction price* as the amount of consideration that an entity expects to receive from a customer in exchange for transferring goods or services. At contract inception, an entity's expectations reflect the full range of possible cash flow scenarios in the contract. Those expectations are the basis for the entity's negotiated price with the customer. In other words, an entity acting rationally would negotiate a contract price whereby, at contract inception, the consideration the entity expects to receive from the customer would reflect the expected costs to provide the goods or services to the customer plus the expected profit margin. A useful measure of a performance obligation reflects the entity's expected costs of providing the promised goods or services plus a margin. Therefore, the Boards thought that a probability-weighted estimate of consideration would result in the most useful measure of the performance obligations in the contract.

BC82. The Boards rejected the alternative of defining the transaction price as an amount that passes a specified threshold (for example, *certain*, *most likely*, or *probable* consideration to be received from the customer). The Boards thought that any specified threshold would be arbitrary and noted that contracts that pass that threshold would be accounted for differently from contracts that do not. That could result in different accounting for similar contracts, depending on how closely a contract passes or misses the specified threshold. Moreover, measuring the transaction price at an amount that passes a specified threshold may not necessarily be a useful measure of the entity's performance obligations.

BC83. Some respondents suggested that a probability-weighted estimate of the possible consideration amounts would not be appropriate if the entity is certain to receive one of only two possible consideration amounts. Those respondents indicated that a probability-weighted estimate would result in a transaction price that is not a possible outcome in accordance with the contract. However, the Boards decided that a probability-weighted amount would provide more useful information because it appropriately reflects the conditions that are present at each reporting date. For example, consider an entity that has equal probabilities of receiving either \$60 or \$80 depending on whether the entity meets a specified performance condition. A transaction price of \$60 would not reflect the possibility of receiving additional consideration. Conversely, a transaction price of \$80 would not reflect the risk of receiving a lesser amount. Therefore, even though the probability-weighted amount of \$70 $[(\$60 \times 50 \text{ percent}) + (\$80 \times 50 \text{ percent})]$ does not reflect either of the possible consideration amounts, the Boards think that it appropriately reflects the conditions at the reporting date.

Subsequent changes in the transaction price

BC84. After contract inception, an entity revises its expectations about the amount of consideration to be received as uncertainties are resolved or new information about remaining uncertainties becomes available. To depict conditions that exist at each reporting date (and changes in conditions during the reporting period), the Boards decided that an entity should update its estimate of the transaction price throughout the contract. The Boards believe that depicting current conditions would provide more useful information to users than retaining the initial estimates, especially for long-term contracts subject to significant changes in conditions during the life of the contract.

BC85. The Boards considered whether, if the transaction price changes during a contract, an entity should:

- (a) recognize those changes in profit or loss when those changes occur; or
- (b) allocate those changes to all performance obligations.

BC86. The Boards rejected the alternative of recognizing the entire amount of a change in the estimate of the transaction price in profit or loss when that change occurs. In the Boards' view, that alternative could result in a pattern of revenue recognition that does not faithfully depict the pattern of the transfer of goods or services. Moreover, recognizing revenue immediately (and entirely) for a change in the estimate of the transaction price would be prone to abuse in practice. The Boards considered whether changes in the estimate of the transaction price could be

presented as a gain or loss separately from revenue, thus preserving the pattern of revenue recognition. However, the Boards rejected that alternative because the total amount of revenue recognized for the contract would not equal the amount of consideration received from the customer.

- BC87. Instead, the Boards decided that an entity should allocate a change in the transaction price to all performance obligations in the contract because the cumulative revenue recognized would depict the revenue that the entity would have recognized if, at contract inception, it had the information that was available at the subsequent reporting date. Consequently, the transaction price that is allocated to performance obligations that have already been satisfied would be recognized as revenue immediately.
- BC88. Some respondents suggested that the entire change in the transaction price should be allocated only to some performance obligations (for example, only to the remaining performance obligations or only to those performance obligations to which the uncertainty primarily relates). The Boards rejected that alternative because the goods or services in a single contract (as identified using the segmentation principle in paragraph 15) have interdependent prices. Allocating a change in the transaction price to only some performance obligations would be inconsistent with the requirement to allocate the transaction price at contract inception to all performance obligations on a relative selling price basis. The Boards thought that allocating subsequent changes in the transaction price differently from the initial allocation would result in a lack of discipline on how an entity should identify separate performance obligations and allocate consideration to them.
- BC89. Updating the estimate of the transaction price after contract inception (and reallocating it to the performance obligations) differs from remeasuring the performance obligations as discussed in paragraphs BC130–BC148 because the entity is remeasuring the customer consideration (that is, the inflows). The entity does not remeasure the expected costs to satisfy the remaining performance obligations (unless the performance obligations become onerous).

Constraining revenue recognition when consideration is variable

- BC90. The Boards considered whether to constrain revenue recognition if the customer promises a variable amount of consideration. The Boards decided to constrain the transaction price because revenue is an important measure to users of financial statements when valuing an entity and because a significant portion of errors in financial statements have related to the overstatement or premature recognition of revenue.

- BC91. The Boards considered existing standards and practices and obtained feedback from various parties, including users of financial statements, to identify the situations in which estimating the transaction price would provide useful information to users of financial statements. That feedback suggested that a probability-weighted estimate of the consideration to be received would be useful only if the entity can identify the possible consideration amounts and reasonably estimate the probabilities of those amounts.
- BC92. For an entity to identify possible amounts and reasonably estimate their probabilities, the Boards concluded that the entity would need experience (either its own or the experience of others) with similar types of contracts. Without that experience, the level of uncertainty in the estimate of the variable consideration would be too high for users to find useful the measurement of any revenue recognized on the basis of that estimate. In other words, a user might find it more useful if an entity recognizes revenue only when the uncertainty is resolved.
- BC93. The Boards decided that experience was necessary but not sufficient to estimate variable consideration reasonably. The entity's experience must also be relevant to the contract because the entity does not expect significant changes in circumstances (that is, the circumstances surrounding the current contract are similar to those surrounding the similar contracts in the past). To help an entity assess whether its experience is relevant to the contract, the Boards decided to specify factors that would reduce the relevance of that experience. Those conditions were derived in part from existing guidance in U.S. GAAP on estimating sales returns.
- BC94. The Boards considered and rejected the following alternatives:

Alternative	Reasons for rejection
Require estimates of the transaction price, but limit cumulative revenue recognized so that it does not exceed amounts that are certain	<ul style="list-style-type: none"> • It conflicts with the core principle of the proposed guidance because in some circumstances, an entity would not recognize revenue when a good or service is transferred to the customer. • It can result in the recognition of losses when the contract is profitable. If revenue is not recognized, an entity would recognize a loss unless the costs of providing the good or service are deferred. The Boards think that the costs relating to a good or service already transferred to the customer would not give rise to a

Alternative	Reasons for rejection
	<p>recognizable asset.</p> <ul style="list-style-type: none"> Although it would be consistent with the guidance on multiple-element arrangements in Subtopic 605-25, it would be inconsistent with IFRSs and other guidance in U.S. GAAP, such as Subtopic 605-35.
<p>Require estimates of the transaction price for only some types of uncertainty (for example, uncertainty that is primarily controlled by the entity)</p>	<ul style="list-style-type: none"> Uncertainty is rarely, if ever, controlled by just one party or attributable to one single factor. Hence, it would be difficult and subjective to distinguish the various types of uncertainty (for example, seller-controlled versus customer-controlled uncertainty). Even if it were possible to distinguish the various types of uncertainty, some exceptions might still be necessary depending on the <i>amount</i> of uncertainty. For example, some might think that an entity should not estimate uncertain consideration that is primarily controlled by the customer. However, many are comfortable with estimates of customer-controlled uncertainty if the entity has extensive experience with those types of contracts (for example, commissions of an insurance agent). The proposed guidance could become unnecessarily complex and would lack a clear principle for how to account for variable consideration.

BC95. Some think that the Boards should retain the existing requirement in the guidance on multiple-element arrangements in Subtopic 605-25 that limits the amount of consideration allocated to a satisfied performance obligation to the amount that is not contingent on the satisfaction of performance obligations in the future (or meeting other specified performance conditions). They reason that if an entity recognizes revenue in such situations, the resulting contract asset does not meet the definition of an asset. However, the Boards disagreed and think that the contract asset recognized in such situations does meet the definition of

an asset. Although the entity may not have the present right to collect consideration from the customer, it clearly has a valuable contractual right as a result of satisfying performance obligations. If the entity were to transfer the remaining rights and performance obligations in the contract to a third party, it would expect to be compensated for its past performance. The Boards therefore think that, in concept, uncertainty in the amount of consideration should be reflected in the measurement of the contract asset rather than through recognition.

Collectibility (paragraph 43)

- BC96. The core principle of the proposed guidance is for an entity to recognize as revenue the amount of consideration the entity receives, or expects to receive, in exchange for transferring goods or services to the customer. Therefore, the Boards considered how an entity should account for any uncertainty arising from the possibility that the customer may be unable to pay—that is, uncertainty about the collectibility of the promised consideration.
- BC97. An entity's assessment of collectibility could affect either or both of the following:
- (a) the recognition of revenue (that is, whether an entity recognizes revenue when a good or service is transferred);
 - (b) the amount of revenue (that is, how much revenue an entity recognizes when a good or service is transferred).
- BC98. Some existing standards address collectibility through recognition. For example, Section 605-10-S99 (SEC SAB Topic 13, *Revenue Recognition*) states that revenue can be recognized only if “collectibility is reasonably assured.” In IFRSs, IAS 18 specifies that revenue is recognized only when “it is probable that the economic benefits associated with the transaction will flow to the entity.” However, the Boards noted the following consequences of having collectibility as a recognition criterion, similar to criteria in some existing standards:
- (a) The Boards would need to specify a probability threshold (for example, *reasonably assured* or *probable*) that must be passed before revenue would be recognized. However defined, that threshold could be viewed as arbitrary. In addition, it would result in no revenue being recognized if the threshold is not passed, but potentially all of the revenue being recognized if it is passed.
 - (b) It would not be consistent with the core principle of the proposed guidance because if the probability threshold is not passed, no revenue would be recognized when a good or service is transferred to the customer.

- (c) Even with a threshold, the Boards would need to decide whether and, if so, how collectibility would affect the amount of revenue once the specified threshold is passed.
- (d) It would not be consistent with the accounting for a receivable, which incorporates uncertainty of collectibility in the measurement of that financial asset.

BC99. Accordingly, the Boards propose that uncertainty about the entity's ability to pay the consideration should be reflected in the measurement of the transaction price and, therefore, in the amount of revenue recognized when an entity satisfies a performance obligation.

BC100. Including the uncertainty of collectibility in the measurement of revenue means that the transaction price reflects the amount of consideration that the entity expects to receive. For many contracts, an entity would expect to collect the full amount of promised consideration because the effect of the customer's credit risk would be immaterial. For those contracts, recognizing the full amount as revenue would be consistent with IAS 39, *Financial Instruments: Recognition and Measurement*, which acknowledges that short-term receivables with no stated interest rate may be measured at the invoiced amount if the effect of discounting is immaterial. However, if the effect of the customer's credit risk is material, the transaction price would be the probability-weighted amount of consideration that the entity expects to receive. If the effect of the time value of money was also material to a contract, the adjustment for collectibility would be made through the discount rate (see paragraphs BC102–BC105).

BC101. After the entity has obtained an unconditional right to consideration, the customer's credit standing could deteriorate or, alternatively, it could improve. If the entity has recognized revenue, the effects of the resulting reassessments of credit risk could be recognized in the period of change as an adjustment to the revenue recognized or as an expense or income that is recognized separately from revenue. The Boards decided that the latter approach was most consistent with the proposed guidance, which focuses on the exchange between the entity and its customer. In effect, once the entity has satisfied the performance obligation, it has received an asset in exchange—a promise of payment. Hence, any reassessment of the customer's credit standing should be recognized as an impairment (or reversal of impairment) of the receivable rather than a change to the amount of revenue previously recognized. The Boards noted that this accounting would be similar to the accounting for noncash consideration received in exchange for a good or service—for example, an equity stake in another entity—if the value of that asset subsequently decreased. The revenue recognized would reflect the value of the equity stake at the date the good or service was transferred—that is, the value of the asset the entity received in exchange for providing the good or service—and any

subsequent change in the value of that equity stake would not affect revenue.

The time value of money (paragraphs 44 and 45)

BC102. Some contracts contain a financing component (either explicitly or implicitly) because performance by an entity (that is, satisfaction of a performance obligation) and payment by its customer occur at significantly different times.

BC103. The Boards propose that the amount of promised consideration from the customer should be adjusted to reflect the time value of money if the contract includes a material financing component. In other words, the amount of the transaction price that is allocated to the performance obligations should be the nominal amount of the consideration, adjusted for the financing component. Hence, when a performance obligation is satisfied, the amount of revenue recognized is the amount of the transaction price adjusted for the financing—in effect, the “cash sales price” of the underlying good or service. Interest income or expense is recognized on the contract asset or contract liability. In support of this approach, the Boards observed that:

- (a) Entities are not indifferent to the timing of the cash flows in a contract. Therefore, reflecting the time value of money portrays an important economic feature of the contract. A contract in which the customer pays for a good or service when that good or service is transferred to the customer is different from a contract in which the customer pays significantly before or after the good or service is transferred. Even if an entity charges its customer the same nominal amount in both cases, it has, in fact, charged different amounts in each case once the financing has been taken into account. Hence, to be useful to users, the accounting should reflect those differences.
- (b) Not recognizing the financing component could misrepresent the profit of a contract. For example, if the financing component is ignored and a customer pays in advance, the entity would recognize income (in the form of interest earned on the cash received) from the contract before it transfers any good or service to the customer. In effect, this front-ends the recognition of profit from the contract. That is because, rationally, that interest was received as compensation for accepting a lower nominal price for the good or service. Similarly, if a customer pays in arrears, ignoring the finance component of the contract would result in full profit recognition on the transfer of the good or service, despite the ongoing cost to the entity of providing financing to the customer.

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

BC104. The Boards considered whether the rate used to reflect the financing should be the risk-free rate. That rate would be observable and simple to apply, and it would avoid the costs of determining a rate specific to each contract. However, the Boards concluded that using the risk-free rate would not result in useful information because the resulting interest would not reflect the characteristics of the parties to the contract. In addition, the Boards noted that it would not necessarily be appropriate to use any rate explicitly specified in the contract because the entity might offer “cheap” financing as a marketing incentive and, hence, using that rate would not result in an appropriate recognition of profit over the life of the contract. Therefore, the Boards propose that an entity should use the rate that would be used in a financing transaction between the entity and its customer that did not involve the provision of goods or services because that rate would reflect the characteristics of the parties to the contract. However, because that rate also would reflect the customer’s credit worthiness, the Boards have specified that an entity should not also adjust the amount of the promised consideration for collectibility.

BC105. Some existing standards require an entity to recognize the effects of financing only if the time period exceeds a specified period, often one year. For example, paragraph 835-30-15-3 excludes those “...transactions with customers or suppliers in the normal course of business that are due in customary trade terms not exceeding approximately one year.” The Boards decided against that approach and instead decided to require management to use its judgment to assess whether the effects of the time value of money are material to the contract. The Boards observed that the time value of money could be material for short-term contracts with high implicit interest rates and, conversely, may be immaterial for long-term contracts with low implicit interest rates.

Noncash consideration (paragraphs 46 and 47)

BC106. When an entity receives cash from a customer upon delivery of a good or service, the transaction price and, hence, the amount of revenue is the amount of cash received—that is, the value of the inbound asset. To be consistent with that approach when the customer pays noncash consideration (for example, goods or services), the Boards decided that the entity also should measure noncash consideration (or promises of noncash consideration) at fair value.

BC107. If an entity cannot estimate the fair value of the noncash consideration reliably, the Boards decided that it should measure the promised consideration indirectly by reference to the selling price of the goods or services promised in exchange for the consideration. That approach is consistent both with requirements in some existing revenue standards (for example, IAS 18) and with requirements for other situations in which the fair value of the assets surrendered in exchange for assets received may be estimated more reliably (for instance, both Topic 718 on stock compensation and IFRS 2, *Share-based Payment*, state that if the fair value of the goods or services received cannot be estimated reliably, then the entity measures them indirectly by reference to the fair value of the granted equity instrument).

Consideration payable to the customer (paragraphs 48 and 49)

BC108. In some cases, an entity pays consideration to one of its customers or to other parties that purchase the entity's goods or services from its customers (for example, an entity may sell a product to a dealer or distributor and subsequently make a payment to a customer of that dealer or distributor). That consideration might be a payment in exchange for goods or services received from the customer, a discount or refund for goods or services provided to the customer, or a combination of both.

BC109. To help an entity distinguish among those types of payments, the Boards decided that an entity should account for any good or service received in the same way as for other purchases from suppliers only if the good or service is distinct, using the same criteria proposed to identify a separate performance obligation. Existing requirements in U.S. GAAP (Section 605-50-45) on vendor's consideration given to a customer use the term *identifiable benefit*, which is described as a good or service that is "sufficiently separable from the recipient's purchase of the vendor's products such that the vendor could have entered into an exchange transaction with a party other than a purchaser of its products or services in order to receive that benefit." The Boards think that notion is similar to the principle in the proposed guidance for assessing whether a good or service is distinct.

BC110. The amount of consideration received from the customer for goods or services and any payment of consideration to that customer for goods or services could be linked. For instance, a customer may pay more for goods or services from the entity than it would otherwise have done if it was not receiving a payment from the entity. Therefore, to depict revenue faithfully in such cases, the Boards concluded that any amount accounted for as a payment to the customer for goods or services received should be limited to the fair value of those goods or services,

with any amount in excess of the fair value recognized as a reduction to the transaction price.

BC111. If the payment of consideration is accounted for as a reduction of the transaction price, the entity would recognize less revenue when it satisfies the related performance obligation(s). However, in some cases an entity promises to pay consideration to a customer only after the entity has satisfied the performance obligation and, hence, after it has recognized revenue. Accordingly, the Boards have specified that the reduction to revenue is recognized at the later of when the entity transfers the goods or services to the customer or the entity promises to pay the consideration. By using the phrase *promises to pay*, the Boards intend to clarify that an entity should reflect in the transaction price payments to customers that are conditional on future events (for example, a payment to a customer conditional on the customer making a specified number of purchases).

Allocating the transaction price to separate performance obligations (paragraphs 50–53)

BC112. In the Discussion Paper, the Boards proposed that an entity should measure performance obligations in a contract by allocating the transaction price to those obligations. That allocation would determine the amount of revenue that an entity recognizes as it satisfies each performance obligation and the measurement of the remaining performance obligations at each reporting date. The Boards considered, but rejected, an alternative measurement approach, which would have been to measure the performance obligations directly at each reporting date. The Boards concluded that this alternative would make accounting for the contract more complex. In addition, the Boards expected that it would provide little additional information to users of financial statements in many cases, either because the values of goods or services promised are not inherently volatile or because the effect of any volatility that might exist is limited because an entity transfers the goods or services to the customer over a relatively short time.

BC113. The Discussion Paper noted that the transaction price could be allocated using various bases, such as the standalone selling price of the promised goods or services or the expected cost of the promised goods or services, as estimated by the entity at contract inception. The Boards proposed that an entity should allocate the transaction price in proportion to the standalone selling prices of the promised goods or services. They noted that an allocation based on standalone selling prices faithfully depicts the different margins that may apply to promised goods or services. In contrast, allocating the transaction price on the basis of the expected costs to provide the goods or services would be expected to

result in a contract-wide margin being applied to all performance obligations in the contract.

BC114. Most respondents agreed with the Boards' proposals in the Discussion Paper, although some suggested that the Boards should consider whether to:

- (a) constrain the use of estimates and specify a hierarchy for the basis of allocation (paragraphs BC115–BC121);
- (b) use the residual method as a basis for allocation (paragraphs BC122–BC125); or
- (c) change the basis for allocating a discount within a contract (paragraphs BC126–BC129).

Use of estimates

BC115. Some respondents were concerned that recognizing revenue on the basis of estimated standalone selling prices of goods or services could result in arbitrary accounting, reduce comparability in financial reporting, and enable management to manipulate those estimates to accelerate or defer revenue. Expressing similar concerns, other respondents suggested that the Boards should prescribe a measurement hierarchy similar to that in Subtopic 605-25 to provide greater discipline in estimating standalone selling prices. That hierarchy requires an entity to determine a standalone selling price using vendor-specific objective evidence (VSOE) of selling price, if it exists. Otherwise, an entity would use third-party evidence (TPE) of selling price, if it exists, or the best estimate of the selling price if neither VSOE nor TPE exists.

BC116. The Boards confirmed that standalone selling prices would sometimes need to be estimated in order to achieve the objective of recognizing revenue when goods or services are transferred to the customer. An alternative approach of allocating consideration only to those performance obligations for which the entity has directly observable prices would not always meet that objective.

BC117. Compared with the proposals in the Discussion Paper, there would be fewer instances under the proposed guidance in which the transaction price would be allocated using estimates of standalone selling prices. That is because under the proposed guidance, entities allocate the transaction price only to separate performance obligations for distinct goods or services rather than potentially to every performance obligation in the contract. As specified in paragraph 23, separate performance obligations are identified only for promises to transfer goods or services that either:

- (a) are sold separately—in which case there would be observable prices for goods or services that are identical or similar to the promised goods or services; or
- (b) have a distinct function and a distinct profit margin—in which case an entity should have sufficient information to reasonably estimate a standalone selling price for the promised good or service.

BC118. For this reason, the Boards think that the proposed guidance should ease concerns expressed by respondents to the Discussion Paper relating to:

- (a) using estimates of standalone selling prices to allocate the transaction price; and
- (b) the practical difficulties with developing those estimates for individual performance obligations.

BC119. Furthermore, practice under U.S. GAAP is becoming accustomed to a greater use of estimates in recognizing revenue. That is because ASU 2009-13 amended Subtopic 605-25 on recognizing revenue in multiple-element arrangements to require an entity to estimate the standalone selling price of a good or service if neither VSOE nor TPE of a standalone selling price is available.

BC120. The Boards reaffirmed the view they expressed in the Discussion Paper that they will not preclude or prescribe any particular method for estimating a standalone selling price so long as the method:

- (a) is consistent with the basis of a standalone selling price (that is, the price at which the entity would sell the distinct good or service if it were sold separately to the customer); and
- (b) maximizes the use of observable inputs.

BC121. The Boards decided against specifying a hierarchy of acceptable estimation methods. The Boards observed that even if there is third-party evidence of a selling price, that price might require adjustments to reflect differences either in (a) the good or service (because the third-party price could be for a similar, rather than identical, good or service) or (b) pricing strategies between the third party and the entity. Hence, there is little distinction between TPE and best estimate in the hierarchy in Subtopic 605-25. The Boards concluded that it was important to emphasize that when using estimates, an entity should maximize the use of observable inputs.

Residual method

- BC122. The residual method is an alternative way to allocate consideration in a multiple-element arrangement in the absence of an observable selling price (such as VSOE or TPE) for delivered items. With the residual method, remaining performance obligations in a contract are measured directly using objective and reliable evidence of the selling prices of the underlying goods or services. Any difference between that amount and the total transaction price is recognized as revenue for the satisfied performance obligations.
- BC123. Some respondents to the Discussion Paper suggested that the proposed guidance should permit the residual method because it provides a less complex and, hence, less costly alternative to allocating the transaction price to separate performance obligations on a relative selling price basis.
- BC124. However, the Boards noted that the residual method is unnecessary if an entity is required to estimate standalone selling prices. The Boards noted that ASU 2009-13 amended Subtopic 605-25 to preclude the use of the residual method as a consequence of the EITF's decision to require entities to use estimated standalone selling prices for goods or services for which there is no VSOE or TPE.
- BC125. Consequently, the Boards confirmed their view that the residual method should not be used to allocate the transaction price to separate performance obligations. However, the Boards noted that a residual (or reverse residual) technique may be an appropriate method for estimating a standalone selling price if there is a directly observable price for one performance obligation but not the other.

The allocation of a discount within a contract

- BC126. A consequence of allocating the transaction price to each performance obligation in proportion to the standalone selling prices of the underlying goods or services is that any discount in the contract is allocated to all performance obligations. A few respondents to the Discussion Paper were concerned with this outcome and suggested that the allocation should be based on either:
- (a) management's assessment of which goods or services are transferred to the customer at a discount to their standalone selling price; or
 - (b) the prices stated in the contract.
- BC127. The Boards were not persuaded to provide an exception to the proposed requirement of allocating the transaction price on the basis of standalone

selling prices. The Boards' view is that the transaction price is for the contract as a whole. Therefore, any discount in the contract is attributable to the contract as a whole and should be allocated proportionally to the separate performance obligations in the contract.

BC128. The Boards disagreed with the suggestion that management should choose the performance obligations to which the discount is allocated because that would reduce the discipline of the process of allocating the transaction price. However, if an entity has evidence that a discount relates only to some goods or services in a contract, the contract may meet the criteria in paragraph 15 for segmentation of the contract.

BC129. The Boards also disagreed with the suggestion that the allocation of the transaction price should be based on the prices stated in the contract. In the Boards' view, a contractually stated price for a good or service in a contract cannot be presumed to represent the selling price for those goods or services. Consequently, the Boards decided that a standalone selling price would need to be determined for a good or service even if the stated contract price for that good or service is zero.

Onerous performance obligations (paragraphs 54–56)

BC130. The proposed guidance specifies that an entity initially measures the separate performance obligations in a contract by allocating the transaction price to the performance obligations. Hence, as the entity satisfies each performance obligation, the reduction in the total amount of the entity's remaining performance obligations reflects the entity's transfer of goods or services to the customer.

BC131. In the Discussion Paper, the Boards noted that the amount of an entity's performance obligations could change for reasons other than an entity's performance (for example, for changes in the price or quantity of goods or services that an entity expects to transfer to the customer to satisfy its remaining performance obligations). The Boards also noted that reflecting those changes in the measurement of the performance obligations would require an entity to remeasure its performance obligations at each reporting date. In the Discussion Paper, the Boards rejected such an approach because they concluded that it would be unnecessarily complex for most contracts with customers.

BC132. The Boards observed that for most contracts with customers, the most significant change in an entity's performance obligations arises from the transfer of goods or services to the customer. Changes for other reasons are typically not significant. However, the Boards acknowledged that sometimes those changes can be significant to the depiction of an entity's obligation to provide goods or services and that in such cases an entity would need to update the initial measurement of the performance

obligations (that is, remeasure them) for reasons other than an entity's transfer of goods or services to the customer. Accordingly, in the Discussion Paper the Boards proposed that an entity should remeasure a performance obligation and recognize a contract loss if the performance obligation is onerous (that is, the entity's expected costs to satisfy the performance obligation exceed its carrying amount).

BC133. Most respondents agreed with the proposed approach of remeasuring performance obligations by exception only when they are onerous. Most agreed with the Boards that remeasuring performance obligations over the life of the contract would be unnecessarily complex and also noted that such an approach would represent a significant change to current practice. A few respondents stated that performance obligations should never be remeasured and that losses on a contract should emerge over time as the revenue is recognized. However, the Boards disagreed with that view, noting that:

- (a) both U.S. GAAP and IFRSs include an onerous test for loss-making contracts (that is, the amount allocated to the performance obligations must at least equal the expected costs to satisfy the performance obligations). Not having such a test would be a major change to current practice.
- (b) the onerous test can be viewed as the mirror image for liabilities of an asset impairment test (that is, a test to ensure that the carrying amount of a performance obligation is not understated).

BC134. Therefore, the Boards concluded that an onerous test is a necessary component of a revenue recognition model in which the initial measurements of performance obligations are not routinely updated. Moreover, including the onerous test in the proposed guidance would achieve greater convergence of U.S. GAAP and IFRSs on the margins reported from contracts with customers.

Components of the onerous test

BC135. In developing the onerous test for contracts with customers, the Boards considered:

- (a) the unit of account for applying the onerous test (paragraphs BC136 and BC137);
- (b) when a performance obligation should be deemed onerous (paragraphs BC138 and BC139);
- (c) the measurement basis for the onerous test (paragraphs BC140 and BC141).

BC136. The unit of account for applying an onerous test could be at the level of either the remaining performance obligations in the contract or each separate performance obligation. If an onerous test is applied at the

contract level, a contract loss would be recognized only if the remaining performance obligations considered together are loss-making. In contrast, if the onerous test is applied to separate performance obligations, an entity would recognize adverse changes in circumstances affecting a separate performance obligation as soon as they result in that separate performance obligation being loss-making. They are not offset against the margin in other parts of the contract.

BC137. The Boards decided to apply the onerous test to each separate performance obligation to maintain consistency with the model's objective to reveal different margins on different parts of the contract. Those different margins are revealed by identifying separate performance obligations and consequently the same unit of account should apply to test whether those separate performance obligations are onerous. A consequence of this approach is that an entity might need to recognize a contract loss for a separate performance obligation even though the contract as a whole remains profitable. However, the Boards concluded that this would be preferable to applying the onerous test at the level of the whole contract because this could delay reporting adverse changes in circumstances.

BC138. In the Discussion Paper, the Boards considered two approaches to determining whether a performance obligation is onerous:

- (a) when the *expected costs* to satisfy the performance obligation exceed the amount of the transaction price allocated to it (cost trigger);
- (b) when the *current price* of the performance obligation (that is, the expected costs plus a margin) exceeds the amount of the transaction price allocated to it (current price trigger).

BC139. The Boards noted that the main consequence of using a cost trigger is that any margin in the measurement of the performance obligation would act as a buffer to absorb adverse changes in the performance obligation. In other words, the amount of the performance obligation would remain unchanged until the entity expects that the satisfaction of that performance obligation would result in a loss. In contrast, a current price trigger would not result in the margin acting as a buffer to absorb adverse changes in circumstances, thereby potentially resulting in earlier recognition of the effects of adverse changes in circumstances. The Boards rejected the current price trigger because, as well as increasing the frequency of remeasurements, it would more closely resemble an approach in which the performance obligations are remeasured at each reporting date, an approach that the Boards had rejected (as discussed in paragraph BC131). Almost all respondents agreed with the Boards.

BC140. The Boards concluded in the Discussion Paper that once a performance obligation is onerous, it should be remeasured on a basis that is

consistent with the trigger. Accordingly, they decided that an onerous performance obligation should be measured at the expected cost of satisfying the performance obligation. The Boards discussed whether a margin should be included in the remeasurement of a performance obligation. The rationale for including a margin is that a profit-oriented entity typically does not promise to transfer a good or service to a customer without a margin. However, the Boards noted that including a margin in the remeasurement would be a significant change to the requirements for loss-making contracts in existing standards (for example, Subtopic 605-35 and IAS 11) and would increase the complexity of measuring performance obligations, particularly when observable prices do not exist. Furthermore, some think that it would be counterintuitive for an entity to recognize a profit when it satisfies an onerous performance obligation.

BC141. Almost all respondents agreed with the Boards. However, the Discussion Paper did not specify which costs should be included in the onerous test and in the remeasurement of an onerous performance obligation. Therefore, in developing the proposed guidance, the Boards considered which costs should be included. The Boards decided that, consistent with the proposed guidance on accounting for fulfillment costs (discussed in paragraphs BC149–BC155), costs for the onerous test should be restricted to those that relate directly to a contract. In the absence of specifying a value or a price for the remeasurement, the Boards concluded that this approach would provide a clear objective for which costs should be included. The Boards also clarified that the expected costs to satisfy the remaining performance obligations should reflect all possible outcomes (that is, the amount should be a probability-weighted measure of costs) to be consistent with how an entity would determine the transaction price.

Presentation of the liability for onerous performance obligations

BC142. The Discussion Paper proposed that when an entity remeasures an onerous performance obligation, it should recognize the corresponding amount in profit or loss separately from revenue. The Discussion Paper was less clear on how the effects of the remeasurement would be reflected in profit or loss when the remeasured performance obligation is satisfied. Although the Boards explained that the amount of revenue recognized for the entire contract is the amount of the transaction price, some respondents were concerned that the remeasured amount of the performance obligation would be recognized as revenue, not the amount initially allocated to the performance obligation.

BC143. Because the remeasurement would need to be tracked separately for the purposes of reporting its effects in profit or loss separately from revenue, the Boards concluded that it would be clearer if they specified that the remeasurement is recognized as a liability separate from the contract asset or contract liability. That would be consistent with existing standards and practice and would clarify that the remeasurement and its subsequent accounting should not affect revenue.

Rejection of an alternative measurement approach for some performance obligations

BC144. The Discussion Paper highlighted that the proposed measurement approach might not result in useful information for some contracts, particularly for those with highly variable outcomes. Such contracts include those in which:

- (a) uncertainty is a significant inherent characteristic of the contract;
- (b) the prices of the underlying goods or services are volatile; or
- (c) the duration of the contract is such that significant changes in circumstances are likely.

BC145. Therefore, the Boards sought views from respondents on whether it would be more useful to measure some performance obligations on another basis.

BC146. Most respondents from the insurance industry stated that insurance performance obligations should be remeasured at each reporting date (that is, they should be subject to another measurement approach) rather than being remeasured by exception only when they are onerous. A few other respondents suggested that some or all of the following performance obligations should be remeasured at each reporting date:

- (a) warranties and similar maintenance contracts;
- (b) other stand-ready and conditional performance obligations; and
- (c) long-term and large service contracts for which relatively small changes in circumstances can have significant effects.

BC147. A few respondents had concerns similar to those of the respondents from the insurance industry. However, those respondents thought that the concerns did not justify the use of a different measurement approach for some performance obligations. Those respondents concluded that all performance obligations within the scope of the revenue recognition standard should be subject to the same measurement approach.

BC148. In light of the feedback received, the Boards concluded that all performance obligations within the scope of the proposed guidance should be subject to the same measurement approach. The Boards noted that many of the concerns raised by respondents, in particular

those raised by insurers, would be addressed by the scope of the proposed guidance. In addition, the Boards noted that:

- (a) most warranties within the scope of the proposed guidance would be of short duration. Moreover, even if the warranties were included within the scope of the standard on insurance contracts, it is possible that many would be accounted for using a simplified measurement model that is similar to the allocated measurement approach in the proposed guidance.
- (b) the most common type of stand-ready obligation other than a warranty is a guarantee contract. Those obligations typically meet the definition of a financial instrument or an insurance contract and therefore would not be within the scope of the proposed guidance.
- (c) the remaining types of stand-ready obligations and long-term and large service contracts are currently measured using an allocated transaction price approach, rather than using a direct measurement approach (for example, current exit price).

Contract costs (paragraphs 57–63)

Costs of fulfilling a contract

BC149. In the Discussion Paper, the Boards explained that they did not intend to include specific requirements on cost recognition in a revenue standard. Consequently, the Boards proposed that costs would be recognized as expenses when incurred unless they would be eligible for capitalization in accordance with other standards (for example, standards on inventory; property, plant, and equipment; and capitalized software).

BC150. Many respondents to the Discussion Paper were concerned about the Boards' focus on revenue without considering the accounting for costs associated with contracts with customers. Some respondents, in particular those from the construction industry, said that guidance on profit margin recognition is as important as guidance on revenue recognition. Other respondents, mainly preparers using U.S. GAAP, were concerned about the withdrawal of cost guidance that was developed specifically for their respective industries. Respondents asked the Boards to reconsider the accounting for costs associated with contracts with customers.

BC151. In reconsidering the accounting for those costs, the Boards observed that existing standards would apply to some fulfillment costs (for example, costs incurred in creating inventory or acquiring property, plant, and equipment). However, for other fulfillment costs (for example, contract set-up costs), the Boards acknowledged the lack of clear guidance.

- BC152. In the absence of clear guidance, an entity applying U.S. GAAP might analogize to the guidance on the deferral of direct loan origination costs in paragraph 310-20-25-2. The FASB was concerned about an entity relying on that analogy because those requirements were developed for financial instruments rather than for goods or services in contracts with customers. An entity applying IFRSs would be required to evaluate costs in accordance with IAS 38, which was not developed for the specific context of contracts with customers. In addition, the Boards were concerned that there would be no guidance replacing the existing guidance on precontract costs for construction contracts.
- BC153. Because of those concerns, the Boards decided to develop common requirements for when an entity should recognize an asset that arises when an entity engages in activities that are necessary to enable it to satisfy a performance obligation. In developing those requirements, the Boards' intention is not simply to normalize profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract. Rather, the intention is to focus on the recognition of assets associated with contracts with customers.
- BC154. To provide a clear objective for recognizing and measuring any asset arising from contract fulfillment costs, the Boards concluded that only costs that relate directly to a contract should be included in the cost of the asset.
- BC155. The Boards considered testing for impairment any recognized asset arising from fulfillment costs using one of the existing impairment tests in their respective standards (for example, inventory in Section 330-10-35 or IAS 2; long-lived assets in Section 360-10-35 or IAS 36, *Impairment of Assets*). However, the Boards concluded that to be consistent with the measurement approach of the proposed guidance, the impairment test should be based on comparing the carrying amount of the asset with the remaining amount of consideration from the customer—that is, the amount of the transaction price allocated to the remaining performance obligations. That also would be consistent with the test for identifying whether performance obligations are onerous (as discussed in paragraphs BC130–BC143).

Costs of obtaining a contract

- BC156. The Boards' decision to address the costs of fulfilling a contract does not affect the Boards' decision that an entity should recognize the selling, marketing, advertising, and other costs of obtaining a contract as expenses when the entity incurs those costs. The costs of fulfilling a contract relate to assets separate from the contract (for example, inventory; property, plant, and equipment; and intangible assets), although some of those costs may be incurred as part of the process of

obtaining a contract (for example, engineering and design costs). However, the asset resulting from the costs of obtaining a contract is primarily the contract asset (unless those costs also relate to assets separate from the contract).

BC157. As explained in paragraph BC28, a contract asset is the asset arising from the combination of the remaining rights and performance obligations in a contract. In concept, a contract asset can arise as a result of obtaining a contract if the measure of the remaining rights exceeds the measure of the remaining obligations. If a contract asset is recognized as a result of obtaining a contract, its measure at contract inception generally would depend on the amount the entity is able to include in the pricing of the contract for the level of effort and resources required to obtain that type of contract. Hence, the value of the asset at contract inception would be greater in industries in which obtaining a contract with a customer is costly.

BC158. Consistent with their reasons for rejecting the measurement of performance obligations at exit price (as noted in paragraph BC77), the Boards concluded that an entity should recognize a contract asset and revenue only as a result of satisfying a performance obligation in the contract. Therefore, the proposed guidance specifies that the contract asset is measured at nil at contract inception. Consequently, any costs of obtaining a contract are recognized as expenses when incurred, even if those costs are direct and incremental (for example, incremental costs of securing an investment management contract). That is different from some current practice, in which specified costs of obtaining a contract are recognized as an asset and amortized as the related revenue is recognized.

Presentation (paragraphs 64–68)

BC159. The Boards considered whether to require a gross presentation or a net presentation of the rights and performance obligations in a contract with a customer.

BC160. In the Discussion Paper, the Boards proposed that the remaining rights and performance obligations in a contract would form a single unit of account and would be accounted for, and presented, on a net basis as either a contract asset or a contract liability. The Boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer is dependent on the entity's performance and, similarly, the entity will perform only as long as the customer continues to pay. They concluded that these interdependencies are best reflected by presenting the remaining rights and obligations net in the statement of financial position.

BC161. Most respondents to the Discussion Paper agreed with a net presentation. Subsequently, in developing the proposed guidance, the Boards considered whether the rights and performance obligations in any contracts should be presented on a gross basis, that is, as separate assets and liabilities. In particular, the Boards considered contracts that are subject to the legal remedy of specific performance. The Boards observed that in the event of a breach, such contracts require the entity and the customer to perform as specified in the contract. Therefore, unlike most contracts that can be settled net, specific performance contracts generally would result in a two-way flow of resources between the customer and the entity. The contracts are akin to those financial contracts that are settled by physical delivery rather than by a net cash payment and for which the units of account are the individual assets and liabilities arising from the contractual rights and obligations.

BC162. The Boards decided against making any exception for specific performance contracts. That is because the remedy of specific performance is relatively rare and is not available in all jurisdictions. In addition, it is only one of a number of possible remedies that could be awarded by a court if legal action were taken for breach of contract. Therefore, basing the accounting on a determination of what would happen in that event would both be counterintuitive (because entities do not enter into contracts with the expectation that they will be breached) and difficult (because an entity would need to determine at contract inception what remedy would be awarded by the court if litigation were to take place in the future).

Relationship between contract assets and receivables

BC163. When an entity performs first by satisfying a performance obligation before the customer performs by paying the consideration, the entity has a contract asset—a right to consideration from a customer in exchange for goods or services transferred to the customer.

BC164. In many cases, that contract asset is an unconditional right to consideration—a receivable—because nothing other than the passage of time makes payment of the consideration due. The Boards decided that there was no need for the revenue recognition standard to address the accounting for receivables in addition to revenue recognition. Issues such as the subsequent measurement (or impairment) of receivables and disclosures relating to those assets are already addressed in U.S. GAAP and IFRSs.

BC165. Therefore the Boards decided that once an entity has an unconditional right to consideration, the entity should present that right as a receivable separately from the contract asset and account for it in accordance with existing requirements. Consequently, contract assets are recognized in

accordance with the proposed guidance when an entity has satisfied a performance obligation but does not yet have an unconditional right to consideration, for example because it first needs to satisfy another performance obligation in the contract.

BC166. In many cases, an unconditional right to consideration arises when the entity performs and issues an invoice for payment to the customer. For example, payment for goods or services is often due and an invoice is often issued when the entity has transferred the goods or services to the customer. However, the act of invoicing the customer for payment does not indicate whether the entity has an unconditional right to consideration. For instance, the entity may have an unconditional right to consideration before it invoices (unbilled receivable), if there is nothing but the passage of time before it is able to issue an invoice. In addition, in some cases an entity can have an unconditional right to consideration before it has satisfied a performance obligation. For example, an entity may enter into a noncancellable contract that requires the customer to pay the consideration a month before the entity provides goods or services. On the date when payment is due, the entity has an unconditional right to consideration.

Disclosure (paragraphs 69–83)

BC167. Some of the main criticisms by regulators and users of existing revenue disclosures are that the disclosures are inadequate and lack cohesion with the disclosure of other items in the financial statements. For example, many users complain that entities present revenue in isolation so that users cannot relate revenue to the entity's financial position.

BC168. In light of those deficiencies, the Boards decided to propose a comprehensive and coherent set of disclosures to help users of financial statements understand and analyze how contracts with customers affect an entity's financial statements. In identifying the types of disclosures that might meet that objective, the Boards initially considered:

- (a) the proposals from the Investors Technical Advisory Committee (ITAC) of the FASB for a "principle-based" disclosure framework; and
- (b) the approaches adopted for disclosure in recent standards, including IFRS 7, *Financial Instruments: Disclosures*, and disclosures that were developed by the EITF for ASU 2009-13 (now Section 605-25-50).

BC169. To be consistent with recent standards, the Boards concluded that a comprehensive and coherent set of revenue disclosures should include:

- (a) an explanation of the composition of revenue recognized in a reporting period;
- (b) a reconciliation of changes in contract asset and liability balances from period to period;
- (c) information about performance obligations and onerous performance obligations that the entity has with customers; and
- (d) an explanation of the judgments used in recognizing revenue.

BC170. The Boards' conclusions on the disclosure of this type of information are explained in paragraphs BC172–BC185.

Disclosure objective

BC171. Many recent standards specify a disclosure objective. The Boards decided that the proposed guidance also should specify an objective for the revenue disclosures. The Boards think that interpretation and implementation of the disclosure requirements improve if the overarching objective for the disclosures is clearly stated. That is because preparers can assess whether the overall quality and informational value of their revenue disclosures are sufficient to meet users' needs. The Boards also observed that specifying a disclosure objective would avoid the need for detailed and prescriptive disclosure requirements to meet the specific information needs for the many and varied types of contracts with customers that are within the scope of the proposed guidance. The Boards noted that developing principle-based disclosure requirements is necessary because it would not be possible or appropriate, given the objective of a single revenue standard, to develop specific requirements for specific transactions or industries.

Disaggregation of reported revenue

BC172. Revenue recognized in the statement of comprehensive income is a composite amount arising from many contracts with customers. The revenue could arise from the transfer of different goods or services or from contracts involving different types of customers or markets. The disclosure of disaggregated revenue information helps users to understand the composition of the revenue that has been recognized in a reporting period. The level of disaggregation is important—information is obscured if the disclosure of that information is either too aggregated or too granular.

BC173. The Boards observed that existing standards require revenue to be disaggregated and that those standards specify the basis for the disaggregation. For example:

- (a) IAS 18 requires disclosure of the amount of each significant category of revenue recognized during the period, including

revenue arising from the sale of goods, the rendering of services, interest, royalties, and dividends.

- (b) Topic 280 on segment reporting and IFRS 8, *Operating Segments*, require an entity to disclose revenue for each operating segment (reconciled to total revenue) and to disaggregate its total revenue by products or services (or by groups of similar products or services) and by geography to the extent that the entity's operating segments are not based on different products or services or different jurisdictions. Related disclosure is required on the entity's types of products and services and its major customers. However, the amounts disclosed can be measured on a basis that is used internally and might not accord with the other measurements used for other purposes in U.S. GAAP or IFRSs.

BC174. Feedback from users consulted on revenue disclosures indicated that the basis for meaningfully disaggregating revenue will not be uniform. Depending on the circumstances, the most useful disaggregation could be by type of good or service, by geography, by market or type of customer, or by type of contract. The Boards were persuaded by this view and concluded that the proposed guidance should not prescribe a specific characteristic of revenue to be used as the basis for disaggregation. Instead, the Boards propose that an entity should disaggregate revenue into categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.

BC175. The Financial Statement Presentation project is considering a presentation approach whereby an entity would disaggregate income and expense by nature and by function. That approach is similar to the disaggregation requirement in paragraph 74 of this proposed guidance. The Boards will consider whether separate disaggregation requirements are necessary for revenue when they review feedback on the Financial Statement Presentation project.

Reconciliation of contract balances

BC176. For users to assess the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers, they need to understand the relationship between the revenue recognized in a reporting period and the contract asset and liability balances. Among other things, this includes identifying whether the entity typically receives payment before or after transferring goods or services to the customer and quantifying the relationship between revenue recognized and cash flows. Although entities currently recognize working capital balances at each reporting date, such as trade receivables and deferred revenue, users have indicated that the relationship between those balances and

the revenue recognized in the period is unclear. Therefore, to clarify that relationship, the Boards decided that an entity should disclose a reconciliation of the contract asset and liability balances. The entity could present the reconciliation gross or net.

BC177. A gross reconciliation would show the remaining contractual rights and performance obligations in separate columns with a total net amount that links to the statement of financial position. In doing so, the reconciliation would highlight the amount of new contracts obtained and the amount of unsatisfied performance obligations and, hence, indicate the amount of revenue expected to be recognized in the future as a result of contracts that already exist. The Boards acknowledged that this information would be useful to users of financial statements. However, they also noted:

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

BC178. Hence, the Boards decided that an entity should disclose a reconciliation from the opening to the closing aggregate balance of the (net) contract assets and (net) contract liabilities. However, the Boards understand that users are mainly interested in a gross reconciliation because it would result in the disclosure of performance obligations on a gross basis. Therefore, they decided that an entity also should disclose a maturity analysis that shows the amount of its remaining performance obligations and the expected timing of their satisfaction.

BC179. The Boards think that the separate disclosure of remaining performance obligations would enable users to:

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

BC180. The Boards acknowledge that the relevance of a maturity analysis diminishes if those performance obligations arise from contracts that are satisfied shortly after contract inception. Feedback from users indicated that this information is mainly useful for longer term contracts, such as construction contracts and service arrangements. For that reason, the proposed guidance limits the disclosure of the maturity analysis to contracts with an original duration of more than one year.

Description of performance obligations

BC181. Existing standards require entities to disclose their accounting policies for recognizing revenue (see the guidance on notes to financial statements—disclosures in Section 235-10-50 or paragraph 10(e) of IAS 1, *Presentation of Financial Statements*). However, users have suggested that, in many cases, entities provide a “boilerplate” description of the accounting policy adopted without explaining how the accounting policy relates to the contracts that the entity enters into with customers.

BC182. The Boards’ proposals would not change those requirements. However, in response to the concerns raised by users, paragraph 77 would require an entity to provide more descriptive information about its performance obligations.

Onerous performance obligations

BC183. The Boards decided that the disclosures relating to onerous performance obligations should be consistent with the existing onerous contract disclosures in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

Assumptions and uncertainties

BC184. U.S. GAAP and IFRSs have general requirements for the disclosure of significant accounting estimates and judgments made by an entity. Because of the importance placed on revenue by users of financial statements, the Boards decided that the proposed guidance should include specific disclosures on the estimates used and judgments made in determining the amount and timing of revenue recognition.

BC185. The EITF reached a similar conclusion when developing the requirements in Section 605-25-50 for the disclosure of multiple-element arrangements. The EITF consulted extensively to develop disclosures to communicate the judgments used and their effect on the recognition of revenue from multiple-element arrangements. After considering whether those disclosures could apply appropriately to all contracts with customers, the Boards decided that the proposed guidance should

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

Implementation guidance (paragraphs IG1–IG96)

BC186. The Boards decided to include implementation guidance to clarify how the principles in the proposed guidance would apply to features found in various typical contracts with customers. Some of that implementation guidance is based on existing guidance in U.S. GAAP or IFRSs. Consistent with the objective of developing a single revenue recognition model (as discussed in paragraphs BC3 and BC4), the Boards do not intend to provide guidance that would apply only to specific industries.

Sale of a product with a right of return (paragraphs IG5–IG12)

BC187. In the Discussion Paper, the Boards identified two approaches for accounting for goods sold with a right of return:

- (a) a performance obligation approach, whereby the promise to provide a return right is a performance obligation. Under this approach, an entity would allocate some of the transaction price in the contract to that performance obligation and recognize it as revenue when the entity provides return services.
- (b) a failed sale approach, whereby revenue (and costs of sales) is recognized only for goods transferred to customers that are expected to result in successful sales (that is, sales that will not fail). Under this approach, the promise to accept returns would not be a performance obligation.

BC188. The Boards did not express a preliminary view in the Discussion Paper but invited comment on the issue. The views from respondents were mixed. Some respondents disagreed with the performance obligation approach because it would result in the entity recognizing revenue as goods are returned, which they thought was inappropriate because the entity does not retain consideration from customers who return their goods. Furthermore, they observed that the performance obligation approach seems to result in recognition of more revenue than the amount of consideration ultimately retained by the entity. Other respondents disagreed with the failed sale approach because the entity would continue to recognize as inventory the goods expected to be returned even though customers have obtained control of those goods.

BC189. In light of the feedback from respondents and the Boards' subsequent decisions on variable consideration, the Boards refined their analysis of rights of return. The Boards concluded that contracts with a right of return typically include at least two performance obligations—a performance

obligation to provide the good to the customer and a performance obligation for the return right service, which is a stand-ready obligation to accept the goods returned by the customer during the return period.

BC190. In relation to performance obligations to provide goods to customers, the Boards concluded that an entity has made an uncertain number of sales when it provides goods with a return right. That is because it is only after the return right expires that the entity will know with certainty how many sales it has made (that is, how many sales did not fail). Therefore, the Boards decided that an entity should not recognize revenue for sales that are expected to fail because the customer will exercise their return rights.

BC191. Measuring revenue from contracts with return rights can also be viewed as analogous to measuring variable consideration. The return right means that the transaction price—and therefore the amount of revenue—is uncertain at the point of sale. Consistent with their decisions on variable consideration, the Boards decided that revenue should be measured at the expected (probability-weighted) amount of consideration that the entity will retain. Therefore, the entity recognizes a liability for its obligation to refund amounts to customers for those sales that are expected to fail. That refund liability would be measured at the expected (probability-weighted) amount of refunds and credits (for example, a store credit) provided to customers.

BC192. The Boards also considered whether to account for the return right service as a performance obligation separate from the refund liability, by allocating the transaction price between the performance obligation to provide the good and the performance obligation for the return right service. The Boards expect that a return right would generally result in a separate performance obligation because it is functionally distinct from the underlying goods provided under the contract and has a distinct profit margin. Moreover, if an entity does not recognize a performance obligation for the return right service, it will have recognized all of the revenue and margin in the contract once the customer obtains control of the good. Such an outcome might not faithfully depict the entity's performance under the contract.

BC193. However, the Boards also observed that accounting for the return right as a performance obligation would typically require the entity to estimate the standalone selling price of that service. In many cases, the number of returns is expected to be a small percentage of the total sales and the return period is often short (such as 30 days). Therefore, the Boards concluded that the incremental information provided to users by accounting for the return right service as a performance obligation would not justify the complexities and costs of doing so. Accordingly, the Boards decided that an entity should not account for a return right service as a separate performance obligation.

BC194. The Boards also considered how to account for goods that are returned to the entity in saleable condition. The Boards concluded that an entity should not recognize as inventory the products expected to be returned by customers. That is because a right of return does not preclude customers from directing the use of, and receiving the benefit from, goods they have purchased with a right of return. However, the entity would have a contractual right to recover the good from the customer if the customer exercises its option to return the good and obtain a refund. The Boards concluded that the right to recover the inventory asset should be recognized separately from the refund liability because that provides greater transparency and ensures that the asset is considered for impairment testing.

Product warranties and product liabilities (paragraphs IG13–IG19)

BC195. In the Discussion Paper, the Boards proposed that all product warranties (whether described as a manufacturer’s warranty, a standard warranty or an extended warranty) give rise to a separate performance obligation for an entity—the promised service being warranty coverage. Those warranties require an entity to stand ready to replace or repair the product over the term of the warranty. Consequently, in any contract for the sale of a product that includes a warranty, an entity would allocate some of the transaction price to the warranty on a relative selling price basis and recognize that amount as revenue only when the promised warranty services transfer to the customer.

BC196. Most respondents did not support the Boards’ proposals. They either:

- (a) disagreed that all warranties give rise to separate performance obligations; or
- (b) questioned whether identifying a separate performance obligation would provide sufficiently useful information to justify the cost and effort, especially if the warranty period is relatively short.

BC197. In light of the feedback from respondents, the Boards decided to draw a distinction between warranties that provide the customer with coverage for:

- (a) defects that exist when the product is transferred to the customer (a “quality assurance warranty”); and
- (b) faults that arise after the product is transferred to the customer (an “insurance warranty”).

Quality assurance warranty

BC198. A quality assurance warranty is a promise that the product is free from defects at the time of sale. The Boards concluded that this promise does not provide any additional service to the customer—the entity and the customer entered into a contract for the transfer of a product that was not defective. Consequently, a quality assurance warranty in a contract with a customer is not a performance obligation.

BC199. The Boards considered viewing a quality assurance warranty as either:

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

BC200. If an entity is viewed as having a liability to replace or repair a defective product, it would recognize revenue once it transfers the product to the customer. The entity would then judge, using all the available evidence, whether the product was defective and, if so, recognize a separate liability for its obligation to replace or repair that product in accordance with Topic 460 on guarantees or IAS 37. That approach would be similar to current practice for warranties that are neither separately priced nor for an extended term (under U.S. GAAP) or a separately identifiable component of the sales contract (under IFRSs).

BC201. If an entity is viewed as having an unsatisfied performance obligation, the uncertainty about whether the product was defective when transferred to the customer means that it is uncertain whether the entity satisfied its performance obligation. The entity would judge, on the basis of all the available evidence, whether the product was defective and, if so, continue to recognize the performance obligation for that product.

BC202. To be consistent with the accounting for rights of return, the Boards concluded that an entity has an unsatisfied performance obligation if it transfers to a customer a defective product that is subject to a quality assurance warranty. In other words, the sale has failed.

BC203. The Boards rejected the alternative of recognizing the warranty as a separate liability because, if that liability is measured at cost (as it would be at present under Topic 460), the entity would recognize all of the revenue and all of the margin in the contract when the product transfers to the customer. The Boards concluded that an entity should not recognize all of the margin in a contract before it has satisfied all its performance obligations under the contract.

Insurance warranty

BC204. An entity providing an insurance warranty is providing a service in addition to the promise to provide a product that was not defective at the time of sale. The entity is promising to repair or replace the product if it breaks down within a specified period (normally subject to some conditions). This additional service to the customer is a performance obligation and meets the definition of an insurance contract. (Although, in the Insurance Contracts project, the Boards have tentatively decided that warranties issued directly by a manufacturer, dealer, or retailer would be within the scope of this proposed guidance.)

BC205. In some jurisdictions, the law requires an entity to provide warranties with the sale of its products. The law might state that an entity is required to repair or replace products that develop faults within a specified period from the time of sale. Consequently, these statutory warranties may appear to be insurance warranties because they would cover faults arising after the time of sale, not just defects existing at the time of sale. However, in many such cases, the Boards concluded that the law can be viewed as simply operationalizing a quality assurance warranty. In other words, the objective of these statutory warranties is to protect the customer against the risk of purchasing a defective product. But rather than having to determine whether the product was defective at the time of sale, the law presumes that if a fault arises within a specified period (which can vary depending on the nature of the product), the product was defective at the time of sale. Therefore, these statutory warranties should be accounted for as quality assurance warranties.

Product liability laws

BC206. Some respondents to the Discussion Paper questioned whether product liability laws give rise to performance obligations. These laws typically require an entity to pay compensation if one of its products causes harm or damage. The Boards concluded that an entity should not recognize a performance obligation arising from these laws because the performance obligation in a contract with a customer is to provide a product that is not defective. The entity would satisfy that obligation by supplying a product that is not defective.

BC207. Any obligation of the entity to pay compensation for the damage or harm that its product causes is separate from the performance obligation. The Boards noted that an entity would account for this obligation separately from the contract with the customer and in accordance with the guidance on loss contingencies in Subtopic 450-20 or IAS 37.

Principal versus agent considerations (paragraphs IG20–IG23)

BC208. Existing standards require an entity to assess whether it is acting as a principal or an agent when goods or services are transferred to end customers. That assessment determines whether an entity recognizes revenue for the gross amount of customer consideration (if the entity is a principal) or for a net amount after the principal is compensated for its goods or services (if the entity is an agent). Under the proposed guidance, principals and agents would have different performance obligations. A principal controls the goods or services before they are transferred to customers. Consequently, the principal's performance obligation is to transfer those goods or services to the customer. In contrast, an agent does not control the goods or services before they are transferred to customers. The agent facilitates the sale of goods or services between a principal and the customer. Therefore, an agent's performance obligation is to arrange for another party to provide the goods or services to the customer. The transaction price attributable to an agent's performance obligation is the fee or commission that the agent receives for providing those services.

BC209. It may not always be readily apparent whether an entity has obtained control of goods or services before they are transferred to a customer. Similar issues arise in consignment sales. For that reason, the Boards have included in the proposed implementation guidance some indicators that a performance obligation relates to an agency relationship. They are based on the indicators specified in the guidance on principal agent considerations in Subtopic 605-45 and in the illustrative examples accompanying IAS 18.

Customer options for additional goods or services

Identifying the performance obligation (paragraphs IG24–IG26)

BC210. In the Discussion Paper, the Boards highlighted the fact that at least some options for additional goods or services would be performance obligations in a contract with a customer. However, the Boards did not decide when an option for additional goods or services is a performance obligation in an existing contract. Respondents to the Discussion Paper had differing views on whether some or all options for additional goods or services would be performance obligations.

BC211. In subsequent discussions, the Boards observed that it can be difficult to distinguish between:

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

BC212. Similar difficulties in distinguishing between an option and an offer have arisen in U.S. GAAP for the software industry. In response to those practice issues, Section 985-605-15 indicates that an offer of a discount on future purchases of goods or services would be presumed to be a separate option in the contract if that discount is significant and is incremental both to the range of discounts reflected in the pricing of other elements in that contract and to the range of discounts typically given in comparable transactions. The Boards propose similar criteria to differentiate between an option and a marketing or promotional offer. However, to avoid implying that *significant* and *material* are intended to be different recognition thresholds, the Boards refer to the materiality of the right to acquire additional goods or services rather than the significance of that right.

Allocating the transaction price (paragraphs IG86–IG88)

BC213. In accordance with the proposed guidance, the entity must determine the standalone selling price of the option so that part of the transaction price is allocated to the performance obligation. In some cases, the standalone selling price of the option may be directly observable or it may be indirectly observable by, for example, comparing the observable prices for the goods or services with and without the option. In many cases, though, the standalone selling price of the option would need to be estimated.

BC214. Option pricing models can be used to estimate the standalone selling price of an option. The price of an option includes the intrinsic value of the option (that is, the value of the option if it were exercised today) and its time value (that is, the value of the option that depends on the time until the expiry and the volatility of the price of the underlying goods or services). The Boards decided that the benefits to users of allocating some of the transaction price to the price and availability guarantees inherent in the time value component of the option price would not justify the costs and difficulties to do so. However, the Boards concluded that an entity should be able to readily obtain the inputs necessary to measure the intrinsic value of the option in accordance with paragraph IG87 and those calculations should be relatively straightforward and intuitive. This measurement approach is consistent with the

measurement application guidance for customer loyalty points in IFRIC 13, *Customer Loyalty Programmes*.

Renewal options

- BC215. A renewal option gives a customer the right to acquire additional goods or services of the same type as those supplied under an existing contract. The option could be described as a renewal option within a relatively short contract (for example, a one-year contract with an option to renew that contract for a further year at the end of the first and second years) or a cancellation option within a longer contract (for example, a three-year contract that allows the customer to discontinue the contract at the end of each year). A renewal option could be viewed similarly to other options to provide additional goods or services. In other words, the renewal option could be a separate performance obligation in the contract if it provides the customer with a material right that the customer could not otherwise obtain without entering into that contract.
- BC216. However, in cases in which a renewal option provides the customer with a material right, there typically is a series of options. In other words, to exercise any option in the contract, the customer must have exercised all the previous options in the contract. The Boards concluded that determining the standalone selling price of a series of options would be complex. That is because determining the estimated standalone selling prices of the options would require an entity to identify various inputs, such as the standalone selling prices for the goods or services for each renewal period and the likelihood that customers will renew for the subsequent period. In other words, the entity would have had to consider the entire potential term of the contract in order to determine the amount of the transaction price from the initial period that should be deferred until later periods.
- BC217. For that reason, the Boards concluded that it would be simpler for the entity to view a contract with renewal options as a contract for its expected term (that is, including the expected renewal periods) determined on a probability-weighted basis, rather than as a contract with a series of options. Under this approach, an entity would include the optional goods or services that it expects to provide (and corresponding expected customer consideration) in the initial measurement of the contract.
- BC218. The Boards concluded that it would be preferable to reflect uncertainty about the term of the contract in the measurement of the contract rather than, say, on the basis of its most likely term because that approach better reflects the uncertainty of the entity's contract—that is, the existence of the option. Furthermore, although each individual contract

might not run for the expected term, using a probability-weighted approach more appropriately reflects the economics when there is a portfolio of contracts.

BC219. The Boards propose two criteria to distinguish renewal options from other options to acquire additional goods or services. First, the additional goods or services underlying the renewal options must be similar to those provided under the initial contract—that is, the entity continues to provide what it was already providing. Therefore, it is more intuitive to view the goods or services underlying such options as part of the initial contract. In contrast, customer loyalty points and many discount vouchers would be considered to be separate deliverables in the contract because the underlying goods or services may be of a different nature.

BC220. The second criterion is that the additional goods or services in the subsequent contracts must be provided in accordance with the terms of the original contract. Consequently, the entity's position is constrained—it cannot change those terms and conditions and, in particular, it cannot change the pricing of the additional goods or services beyond the parameters specified in the original contract. That is different from examples such as customer loyalty points and discount vouchers. For instance, if an airline frequent flyer program offers “free” flights to customers, the airline is not constrained because it can subsequently determine the number of points that are required to be redeemed for any particular “free” flight. Similarly, when an entity grants discount vouchers, typically it has not constrained itself with respect to the price of the subsequent goods or services against which the discount vouchers will be redeemed.

Licensing and rights to use (paragraphs IG31–IG39)

BC221. Many respondents to the Discussion Paper questioned how an entity would identify performance obligations in a contract in which an entity licenses its intellectual property by granting a customer the right to use that property. Hence, the Boards decided to develop implementation guidance on the issue.

BC222. The Boards noted that some contracts would be accounted for as a sale, rather than a license, of intellectual property because the customer obtains control of that intellectual property. That would be the case if an entity grants the exclusive right to use intellectual property for substantially all of its remaining economic life.

BC223. When developing implementation guidance, the Boards observed that licensing arrangements that are not sales of intellectual property often have characteristics similar to those of a lease. In both cases, a customer purchases the right to use an asset of the entity. The Boards decided tentatively in the Leases project that a lessor should recognize revenue

during the term of the lease as the lessor permits the lessee to use its asset. However, the Boards thought that this pattern of revenue recognition would not be appropriate for all licenses of intangible assets. Consequently, the Boards considered the following potential differences between a licensing arrangement and a lease:

- (a) tangible versus intangible—the Boards decided that it would be difficult to justify why the accounting for a promised asset should differ depending on whether the asset is tangible or intangible. Moreover, in the FASB's Conceptual Framework, the discussion on the nature of assets deemphasizes the physical nature of assets.
- (b) exclusive versus nonexclusive—leases, by nature, are exclusive because the lessor cannot grant the right to use a leased asset to more than one lessee at the same time. In contrast, an entity can grant similar rights to use some intellectual property to more than one customer under substantially the same terms.

BC224. Consequently, the Boards decided that an entity should account for a promise to grant an exclusive right to use intellectual property (which is not a sale of that intellectual property) consistently with their tentative decisions on how a lessor would account for the promise to grant a right to use a tangible asset. That right to use gives rise to a performance obligation that is satisfied continuously over time as the entity permits the customer to use the property over time. Because the entity cannot grant a similar right to more than one customer at the same time, the entity's use of the intellectual property during the license term is constrained for a period of time. In the Boards' view, that constraint over time suggests that the entity has a performance obligation that is not fully satisfied until the end of the license term. The Boards will review their tentative decisions in light of feedback on the proposed guidance and further discussions in the Leases project.

BC225. A license is nonexclusive if the entity continues to retain and control its intellectual property and can use that property to grant similar licenses to other customers under substantially the same terms. In other words, the entity's rights to its intellectual property are not diminished by granting nonexclusive licenses. In those cases, the entity is granting the customer an asset that is separate from the entity's intellectual property. For example, a payroll processing software product contains intellectual property, but the customer's asset is the use and benefit of payroll processing and not access to the entity's intellectual property (that is, the source code). Similarly, when a customer purchases a dress, that dress contains intellectual property for its design, but the customer's asset is the use and benefit of the dress.

BC226. The Boards noted that licensing intellectual property on a nonexclusive basis often is the only way an entity can distribute its product and protect its intellectual property from the unauthorized duplication of its products. They concluded that the asset transferred with a license is, in principle, similar in nature to the promised asset in a sale of any product. Hence, the legal distinction between a license and a sale should not cause revenue recognition on nonexclusive licenses to differ from the sale of other types of products.

Product financing arrangements (paragraph IG51)

BC227. If an entity enters into a contract with a repurchase agreement and the customer does not obtain control of the asset, the contract is a financing arrangement if the price at which the entity repurchases the asset (after reflecting the time value of money) is equal to or more than the original sales price of the asset.

BC228. The FASB noted that if a repurchase agreement is a financing arrangement, an entity applying U.S. GAAP could apply the guidance on product financing arrangements in Subtopic 470-40. However, IFRSs do not have an equivalent standard (the illustrative examples accompanying IAS 18 acknowledge the possibility of a financing arrangement but do not specify the accounting).

BC229. Therefore, to ensure consistent accounting in U.S. GAAP and IFRSs for a financing arrangement that arises from a contract with a customer, the Boards decided to provide guidance consistent with Subtopic 470-40.

BC230. Consequently, the FASB decided to withdraw Subtopic 470-40. It noted that the remaining guidance in Subtopic 470-40 addresses situations in which an entity arranges for another party to purchase products on its behalf and agrees to purchase those products from the other party. In those cases, the entity is required to recognize the products as an asset and to recognize a related liability when the other party purchases the product. The FASB noted that the proposed model would result in similar accounting when the other party acts as an agent of the entity (that is, the other party does not obtain control of the products).

Transition (paragraph 85)

BC231. The Boards decided that an entity should apply the proposed guidance retrospectively in accordance with the guidance on accounting changes in Topic 250 or IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Retrospective application would provide users of financial statements with useful trend information because transactions would be recognized and measured consistently both in the current

period and in the comparative periods presented. The Boards think that it is particularly important for users to be able to understand trends in revenue, given its significance to the financial statements.

BC232. The Boards noted that retrospective application could be burdensome for some entities preparing financial statements, particularly those entities with many long-term contracts. In addition, some entities might find it difficult to estimate standalone selling prices at contract inception and variable consideration throughout the contract without using hindsight. However, the Boards noted that some of those concerns would be addressed by:

- (a) Topic 250 and IAS 8 limiting the retrospective application of an accounting policy if it is impracticable; and
- (b) the Boards contemplating a long lead time between issuing a standard on revenue from contracts with customers and its effective date, which would reduce the extent of hindsight needed in applying that standard.

BC233. Nonetheless, on the basis of that assessment of the potential costs associated with retrospective application, the Boards also considered whether the proposed guidance should instead apply:

- (a) on a prospective basis, either for all new contracts from a specified date or for all contracts (new and existing) from that date; or
- (b) on a limited retrospective basis.

BC234. The Boards rejected the alternative of applying the proposed guidance prospectively because the recognition and measurement of revenue arising from new contracts and existing contracts would not be comparable between the current period and the comparative periods. Moreover, if the requirements were applied prospectively only for new contracts, the recognition and measurement of revenue would not be comparable in the current period.

BC235. The Boards considered whether limiting the retrospective application of the proposed guidance would address some of those preparer concerns and still provide comparable revenue information to users of financial statements. Various alternatives for limiting the retrospective application of the proposed guidance were considered. Those alternatives were based on applying the proposed guidance retrospectively to all contracts except those contracts that are completed at a specified date. That could be a date in the past or a date after the effective date of the proposed guidance. However, the Boards were unable to identify a specific date for limiting the retrospective application of the proposed guidance that, on cost-benefit grounds, would be preferable to full retrospective application.

Effective date and early adoption (paragraph 84)

BC236. The Boards will consider collectively the effective dates and transition for the standards—including revenue recognition—that they have targeted to issue in 2011 and, as part of that consideration, will publish a separate consultation paper to seek comments from interested parties. Hence, the Boards may modify their previously stated preferences in the case of some individual standards. As part of that consideration, the Boards also will address whether early adoption of the standard on revenue from contracts with customers should be permitted.

BC237. Consequently, the proposed guidance does not specify a possible effective date or whether the proposed guidance could be adopted early, but the Boards intend to provide enough time to implement the proposed changes.

BC238. The FASB has indicated a preference to prohibit entities adopting the standard early. The IASB considered the related implications for IFRS 1, *First-Time Adoption of International Financial Reporting Standards*, and decided that IFRS 1 should not provide any exceptions to, or exemptions from, the proposed guidance for first-time adopters of IFRSs. To avoid requiring two changes in a short period, the IASB proposes that first-time adopters should be permitted to adopt the standard early.

Costs and benefits

BC239. The objective of financial statements is to provide information about an entity's financial position, financial performance, and cash flows that is useful to a wide range of users in making economic decisions. To attain that objective, the Boards try to ensure that a proposed standard will meet a significant need and that the overall benefits of the resulting information justify the costs of providing it. Present investors primarily bear the costs of implementing a new standard. Although those costs might not be borne evenly, users of financial statements benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital, including credit, and the efficient allocation of resources in the economy.

BC240. The evaluation of costs and benefits is necessarily subjective. In making their judgment, the Boards consider the following:

- (a) the costs incurred by preparers of financial statements;
- (b) the costs incurred by users of financial statements when information is not available;

- (c) the comparative advantage that preparers have in developing information, compared with the costs that users would incur to develop surrogate information; and
- (d) the benefit of better economic decision-making as a result of improved financial reporting.

BC241. The Boards propose a single standard that would recognize revenue on a consistent and comparable basis for a wide range of contracts with customers. By accounting for those contracts consistently, the proposed standard would address many of the weaknesses and inconsistencies inherent in existing revenue requirements, which have contributed to the existence of diverse practices in the recognition of revenue and, as a result, frequent requests for authoritative guidance on applying those existing requirements to specific transactions or other emerging issues.

BC242. In addition, a single revenue recognition standard would improve comparability in the recognition, measurement, and disclosure of revenue across transactions and across entities operating in various industries. Users have indicated that comparable revenue information is useful when assessing the financial performance of an entity and assessing financial performance across a number of entities. Moreover, a common revenue standard would make the financial reporting of revenue comparable between entities that prepare financial statements in accordance with U.S. GAAP or IFRSs.

BC243. The Boards acknowledge that some preparers and users do not perceive significant weaknesses in some existing revenue standards or in the financial information resulting from applying those standards to some industries. Those preparers and users have therefore questioned whether the benefits from applying a new standard in some industries would be justified by the costs involved in implementing that new standard. However, the Boards concluded that the overall benefits to financial reporting that would result from a single revenue standard being applied consistently across different industries, jurisdictions, and capital markets outweigh the concerns about cost-benefit assessments in particular industries. In addition, in developing their proposals, the Boards have also carried forward some existing requirements where appropriate. That would reduce the amount of change for some entities on implementing a new standard.

BC244. The proposed guidance would change existing revenue recognition practices and some entities would need to make systems and operational changes to comply with the proposed guidance. For example, some preparers have indicated that systems changes would be necessary to estimate variable consideration and contract options. The Boards think that the costs of those changes would be incurred primarily during the transition from existing standards to the proposed standard, whereas the

benefits resulting from increased consistency and comparability in the recognition of revenue would be ongoing.

BC245. The proposed disclosure requirements are more substantial than those required in existing standards. The Boards think that the proposed disclosures would provide users with additional information that explains more clearly the relationship between an entity's contracts with customers and the revenue recognized by the entity in a reporting period. Some users have commented that the proposed disclosures would address deficiencies that exist currently in revenue disclosures.

BC246. As noted in paragraph BC6, since the Discussion Paper was published, members and staff of the Boards have consulted users and preparers across a wide range of industries and jurisdictions. This has allowed the Boards to better understand some of the operational issues arising from their proposals. As a result, the Boards have modified some of their preliminary views in the Discussion Paper to reduce the burden of implementing the proposed revenue recognition model. The Boards will continue to consult widely following publication of the proposed guidance.

BC247. On balance, the Boards concluded that the proposed guidance would improve financial reporting under U.S. GAAP and IFRSs at a reasonable cost. In arriving at that conclusion, the Boards acknowledged that the assessments of costs versus benefits would be different under U.S. GAAP and IFRSs.

Consequential amendments

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

BC248. Subtopic 360-20 on real estate sales provides guidance for recognizing profit on all real estate sales, regardless of whether real estate is an output of an entity's ordinary activities.

BC249. A contract for the sale of real estate that is an output of an entity's ordinary activities meets the definition of a contract with a customer and, therefore, would be within the scope of the proposed guidance. Consequently, the FASB considered the implications of retaining the guidance in Subtopic 360-20 for other contracts. The FASB noted that the recognition of the profit or loss on a real estate sale would differ depending on whether the transaction is a contract with a customer. However, economically there is little difference between the sale of real estate that is an output of the entity's ordinary activities and real estate that is not. Hence, the difference in accounting should relate only to the

presentation of the profit or loss in the statement of comprehensive income—revenue and expense, or gain or loss.

BC250. Therefore, the FASB decided to amend Subtopic 360-20 to require an entity to apply the recognition and measurement principles of the proposed guidance to contracts for the sale of real estate that is not the output of the entity's ordinary activities. However, the entity would not recognize revenue but instead would recognize a gain or a loss.

BC251. The FASB also decided to specify that an entity should apply the recognition and measurement principles of the proposed guidance to contracts for the sale of other tangible assets within the scope of Topic 360 on property, plant, and equipment and intangible assets within the scope of Topic 350 on goodwill and other intangibles. The primary reason for that decision was the lack of guidance in U.S. GAAP on accounting for the sale of those assets when they are not an output of an entity's ordinary activities and do not constitute a business or nonprofit activity.

BC252. In IFRSs, an entity selling an asset within the scope of IAS 16, IAS 38, or IAS 40, applies the recognition principles of IAS 18 to determine when to derecognize the asset and, in determining the gain or loss on the sale, measures the consideration at fair value. However, the IASB understands that there is diversity in practice when the sale of those assets involves contingent consideration. Accordingly, to improve the accounting in IFRSs and ensure consistency with U.S. GAAP, the IASB decided to amend those standards to require an entity to apply the recognition and measurement principles of the proposed guidance to sales of assets within the scope of those standards. The IASB decided that a *reasonably estimated* constraint on the transaction price should also apply to the sale of assets that are not an output of the entity's ordinary activities because entities face similar if not greater challenges in determining the transaction price when the asset is not an output of the entity's ordinary activities than when the asset is an output of its ordinary activities.

Appendix A: Glossary

Defined terms to be added to the Master Glossary include the following:

Contract	an agreement between two or more parties that creates enforceable rights and obligations.
Contract asset	an entity's right to consideration from a customer in exchange for goods or services transferred to the customer.
Contract liability	an entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer.
Control [of a good or service]	an entity's ability to direct the use of, and receive the benefit from, a good or service.
Customer	a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities.
Performance obligation	an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.
Revenue	inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.
Standalone selling price [of a good or service]	the price at which the entity would sell a good or service separately to the customer.

**Transaction price
[for a contract with
a customer]**

the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes).

Appendix B: Summary of Proposed Amendments to the *FASB Accounting Standards Codification*TM

This proposed Accounting Standards Update describes a revenue model applicable to a wide range of industries and transactions. As a consequence, the FASB proposes to supersede or amend various Subtopics in the Accounting Standards Codification. Those proposed amendments are summarized below. The FASB will issue additional details about proposed amendments to the Accounting Standards Codification during the comment period.

The following Subtopics would be superseded:

- 340-20 *Other Assets and Deferred Costs—Capitalized Advertising Costs*
- 360-20 *Property, Plant, and Equipment—Real Estate Sales*
- 430-10 *Deferred Revenue—Overall*
- 470-40 *Debt—Product Financing Arrangements*
- 605-15 *Revenue Recognition—Products*
- 605-20 *Revenue Recognition—Services*
- 605-25 *Revenue Recognition—Multiple-Element Arrangements*
- 605-28 *Revenue Recognition—Milestone Method*
- 605-30 *Revenue Recognition—Rights to Use*
- 605-35 *Revenue Recognition—Construction-Type and Production-Type Contracts*
- 605-45 *Revenue Recognition—Principal Agent Considerations*
- 908-605 *Airlines—Revenue Recognition*
- 910-605 *Contractors—Construction—Revenue Recognition*
- 912-210 *Contractors—Federal Government—Balance Sheet*
- 912-275 *Contractors—Federal Government—Risks and Uncertainties*
- 912-605 *Contractors—Federal Government—Revenue Recognition*
- 915-605 *Development Stage Entities—Revenue Recognition*
- 922-430 *Entertainment—Cable Television—Deferred Revenue*
- 926-430 *Entertainment—Films—Deferred Revenue*
- 926-605 *Entertainment—Films—Revenue Recognition*
- 926-845 *Entertainment—Films—Nonmonetary Transactions*
- 928-430 *Entertainment—Music—Deferred Revenue*
- 928-605 *Entertainment—Music—Revenue Recognition*
- 932-605 *Extractive Activities—Oil and Gas—Revenue Recognition*
- 940-605 *Financial Services—Brokers and Dealers—Revenue Recognition*

- 948-605 *Financial Services—Mortgage Banking—Revenue Recognition*
- 952-340 *Franchisors—Other Assets and Deferred Costs*
- 952-605 *Franchisors—Revenue Recognition*
- 952-720 *Franchisors—Other Expenses*
- 954-430 *Health Care Entities—Deferred Revenue*
- 970-605 *Real Estate—General—Revenue Recognition*
- 972-430 *Real Estate—Common Interest Realty Associations—Deferred Revenue*
- 972-605 *Real Estate—Common Interest Realty Associations—Revenue Recognition*
- 974-605 *Real Estate—Real Estate Investment Trusts—Revenue Recognition*
- 976-310 *Real Estate—Retail Land—Receivables*
- 976-605 *Real Estate—Retail Land—Revenue Recognition*
- 978-310 *Real Estate—Time-Sharing Activities—Receivables*
- 978-340 *Real Estate—Time-Sharing Activities—Other Assets and Deferred Costs*
- 978-605 *Real Estate—Time-Sharing Activities—Revenue Recognition*
- 980-605 *Regulated Operations—Revenue Recognition*
- 985-605 *Software—Revenue Recognition*

The following Subtopics would be amended as described:

Codification Subtopic	Description of proposed amendment
605-10 <i>Revenue Recognition—Overall</i>	Supersede all existing paragraphs in this Subtopic and replace that guidance with the proposed guidance.
605-40 <i>Revenue Recognition—Gains and Losses</i>	<p>Amend to require an entity to apply the proposed revenue recognition and measurement requirements to account for the gain or loss for:</p> <ul style="list-style-type: none"> • Contracts for the sale of nonfinancial assets that are within the scope of Topics 350 and 360 and are not an output of the entity's ordinary activities. An exchange of a group of assets that constitute a business or nonprofit activity (except for the sale of in substance real estate and conveyance of oil and mineral rights) would continue to be accounted for in

Codification Subtopic	Description of proposed amendment
	<p>accordance with Subtopic 810-10.</p> <ul style="list-style-type: none"> • A sale or transfer of an investment in the form of a financial asset that is, in substance, a sale of real estate.
<p>605-50 <i>Revenue Recognition—Customer Payments and Incentives</i></p>	<p>Supersede the guidance relating to:</p> <ul style="list-style-type: none"> • A vendor's accounting for consideration given by a vendor to a customer; and • A service provider's accounting for consideration given by the service provider to a manufacturer or reseller of equipment. <p>Amend the guidance relating to accounting by a customer (including a reseller) for consideration received from a vendor to be consistent with the proposed guidance.</p>
<p>905-605 <i>Agriculture—Revenue Recognition</i></p>	<p>Supersede the guidance relating to "Cooperatives—Patrons."</p>
<p>922-605 <i>Entertainment—Cable Television—Revenue Recognition</i></p>	<p>Supersede the guidance relating to hook-up revenue.</p> <p>Relocate the guidance relating to the "prematurity period" to Subtopic 922-360, <i>Entertainment—Cable Television—Property, Plant, and Equipment</i>.</p>
<p>924-605 <i>Entertainment—Casinos—Revenue Recognition</i></p>	<p>Supersede all paragraphs in the Subtopic, except for paragraphs 924-605-25-2 and 924-605-55-1 through 924-605-55-2, which would be relocated to Subtopic 924-405, <i>Entertainment—Casinos—Liabilities</i>.</p>
<p>942-605 <i>Financial Services—Depository and</i></p>	<p>Supersede the guidance relating to the accounting for commissions.</p>

Codification Subtopic	Description of proposed amendment
<i>Lending— Revenue Recognition</i>	
<i>946-605 Financial Services— Investment Companies— Revenue Recognition</i>	<p>Supersede the guidance relating to:</p> <ul style="list-style-type: none"> • Distributor transfer of rights to certain future distribution fees; and • Distribution fees and costs for mutual funds with no front-end sales fee. <p>Amend paragraph 946-605-25-3 to require the recognition of all selling and marketing costs as expenses when incurred.</p>
<i>954-605 Health Care Entities— Revenue Recognition</i>	<p>Supersede the revenue recognition guidance in paragraphs 954-605-25-2 through 25-8 and paragraph 954-605-25-11. Amend paragraph 954-605-25-1 to reflect the withdrawal of that guidance.</p>
<i>958-605 Not- for-Profit Entities— Revenue Recognition</i>	<p>Amend the guidance on the recognition of exchange transactions in paragraphs 958-605-05-2 and 958-605-25-1.</p> <p>Supersede paragraph 958-605-45-2 relating to gross versus net reporting of revenues.</p>
<i>922-350 Entertainment —Cable Television— Intangibles— Goodwill and Other</i>	<p>Amend paragraph 922-350-25-3 and supersede paragraph 922-350-35-4 to require the recognition of franchise application costs as expenses when incurred.</p>
<i>920-845 Entertainment — Broadcasters — Nonmonetary</i>	<p>Amend paragraph 920-845-30-1 to specify that if an entity cannot reliably estimate the fair value of consideration received, the consideration would be measured indirectly by reference to the selling price of goods or services transferred. Amend the reference in paragraph 920-845-30-2.</p>

Codification Subtopic	Description of proposed amendment
<i>Transactions</i>	
954-340 <i>Health Care Entities— Other Assets and Deferred Costs</i>	Amend paragraph 954-340-25-1 and supersede paragraphs 954-340-25-2(b) and (c) to recognize all selling and marketing costs as expenses when incurred.
970-340 <i>Real Estate— General— Other Assets and Deferred Costs</i>	Supersede paragraphs 970-340-25-7, 970-340-25-13 through 25-17, and 970-340-40-1 through 40-2 to require the recognition of all selling costs as expenses when incurred. Amend paragraph 970-340-35-1 to reflect the withdrawal of Subtopic 976-605.
970-360 <i>Real Estate— General— Property, Plant, and Equipment</i>	Supersede paragraph 970-360-25-4 to reflect the withdrawal of Subtopic 974-605. Supersede paragraphs 970-360-55-4 through 55-5 to reflect the withdrawal of Subtopic 360-20.
210-10 <i>Balance Sheet— Overall</i>	Supersede paragraph 210-10-60-2 to reflect the withdrawal of Subtopic 605-35.
275-10 <i>Risks and Uncertainties—Overall</i>	Supersede paragraph 275-10-60-7 to reflect the withdrawal of Subtopic 605-35.
310-10 <i>Receivables—Overall</i>	Supersede paragraphs 310-10-35-11 and 310-10-50-23 to reflect amendments to Subtopic 605-10. Amend the references in paragraphs 310-10-40-4 through 40-5.
330-10	Supersede paragraphs 330-10-30-19 and 330-10-45-2 to

Codification Subtopic	Description of proposed amendment
<i>Inventory— Overall</i>	reflect the withdrawal of Subtopic 605-35.
<i>340-10 Other Assets and Deferred Cost—Overall</i>	Supersede paragraph 340-10-60-5 to reflect the withdrawal of Subtopic 605-20. Supersede paragraph 340-10-60-6 to reflect the withdrawal of Subtopic 605-35. Supersede paragraph 340-10-60-8 to reflect the withdrawal of Subtopic 912-210.
<i>360-10 Property, Plant, and Equipment—Overall</i>	Supersede paragraphs 360-10-40-3 and 360-10-60-1 to reflect the withdrawal of Subtopic 974-605.
<i>440-10 Commitments—Overall</i>	Amend the references in paragraphs 440-10-15-4 and 440-10-60-5. Supersede paragraph 440-10-60-16 to reflect the withdrawal of Subtopic 948-605. Supersede paragraphs 440-10-60-19 through 60-20 to reflect the withdrawal of Subtopics 976-605 and 980-605.

Codification Subtopic	Description of proposed amendment
<p>460-10 <i>Guarantees— Overall</i></p>	<p>Amend paragraphs 460-10-05-1 and 460-10-25-1 to reflect changes to the guidance on accounting for product warranties.</p> <p>Supersede paragraphs 460-10-05-4, 460-10-15-8 through 15-10, 460-10-25-5 through 25-8, and 460-10-50-7 through 50-8 to reflect amendments to the guidance on accounting for product warranties and the withdrawal of Subtopic 605-20.</p> <p>Amend paragraph 460-10-55-17 to reflect the withdrawal of Subtopic 360-20.</p> <p>Supersede paragraph 460-10-60-3 to reflect the withdrawal of Subtopic 360-20.</p> <p>Supersede paragraphs 460-10-60-8 through 60-10 and 460-10-60-41 to reflect the withdrawal of Subtopics 605-20, 605-15, and 605-35.</p> <p>Supersede paragraph 460-10-60-38 to reflect the withdrawal of Subtopic 926-605.</p>
<p>705-10 <i>Cost of Sales and Services— Overall</i></p>	<p>Supersede paragraphs 705-10-25-4 and 705-10-25-8 to reflect the withdrawal of Subtopic 605-15.</p> <p>Supersede paragraphs 705-10-45-2 through 45-5 to reflect the withdrawal of Subtopic 605-45.</p> <p>Supersede paragraph 705-10-25-12 to reflect the partial withdrawal of Subtopic 605-50.</p>
<p>720-25 <i>Other Expenses— Contributions Made</i></p>	<p>Amend the reference in paragraph 720-25-15-2.</p>
<p>720-35 <i>Other Expenses— Advertising Costs</i></p>	<p>Amend paragraphs 720-35-25-5 and 720-35-35-1 to reflect the withdrawal of Subtopic 340-20.</p>

Codification Subtopic	Description of proposed amendment
730-10 <i>Research and Development</i> —Overall	Supersede paragraph 730-10-60-5 to reflect the withdrawal of Subtopic 985-605.
820-10 <i>Fair Value Measurements and Disclosures</i> —Overall	Amend paragraph 820-10-15-3 to reflect the withdrawal of Subtopic 605-20 and to refer to Subtopic 605-10 (as amended by the proposed guidance).
845-10 <i>Nonmonetary Transactions</i> —Overall	Supersede paragraphs 845-10-05-11, 845-10-15-8(a)(2), 845-10-15-14(b) through 15-17, 845-10-15-20(c), 845-10-25-7 through 25-8, 845-10-30-23, 845-10-55-29 through 55-37, and 845-10-60-2 through 60-3 to reflect the withdrawal of Subtopic 360-20.
850-10 <i>Related Party Disclosures</i> —Overall	Supersede paragraph 850-10-60-8 to reflect the withdrawal of Subtopic 952-605.
855-10 <i>Subsequent Events</i> —Overall	Supersede paragraph 855-10-60-4 to reflect the withdrawal of Subtopic 985-605.
905-310 <i>Agriculture—Receivables</i>	Supersede paragraphs 905-310-25-1 through 25-2 and 905-310-35-1 to reflect partial withdrawal of guidance from Subtopic 905-605.
905-330 <i>Agriculture—Inventory</i>	Supersede paragraphs 905-330-30-3 and 905-330-40-1 to reflect partial withdrawal of guidance from Subtopic 905-605.

Codification Subtopic	Description of proposed amendment
908-360 <i>Airlines— Property, Plant, and Equipment</i>	Amend paragraph 908-360-55-1 to reflect the amendments to Subtopic 605-50.
910-20 <i>Contractors— Construction —Contract Costs</i>	Supersede paragraph 910-20-25-5 to reflect the withdrawal of Subtopic 605-35.
912-20 <i>Contractors— Federal Government —Contract Costs</i>	Supersede paragraph 912-20-45-1 to reflect the withdrawal of Subtopic 912-210.
912-450 <i>Contractors— Federal Government — Contingencies</i>	Supersede paragraph 912-450-25-1 to reflect the withdrawal of Subtopic 912-605.
912-705 <i>Contractors— Federal Government —Cost of Sales and Services</i>	Supersede paragraph 912-705-25-1 to reflect the withdrawal of Subtopic 912-605.

Codification Subtopic	Description of proposed amendment
912-730 <i>Contractors— Federal Government —Research and Development</i>	Amend the reference in paragraph 912-730-15-2. Supersede paragraph 912-730-15-3 to reflect the withdrawal of Subtopic 605-35.
926-10 <i>Entertainment —Films— Overall</i>	Amend paragraph 926-10-05-1 to remove reference to <i>revenue</i> . Supersede paragraph 926-10-15-3(e) to reflect the withdrawal of Subtopic 985-605.
926-20 <i>Entertainment —Films— Other Assets—Film Costs</i>	Amend the reference in paragraph 926-20-35-6 and amend paragraph 926-20-35-14 to reflect the withdrawal of Subtopic 926-605.
942-825 <i>Financial Services— Depository and Lending— Financial Instruments</i>	Amend paragraph 942-825-50-2 to reflect the withdrawal of Subtopic 605-20.
954-310 <i>Health Care Entities— Receivables</i>	Supersede paragraph 954-310-30-1 to reflect the amendment of Subtopic 954-605.
954-440 <i>Health Care Entities— Commitments</i>	Supersede paragraphs 954-440-25-1 through 25-3, 954-440-35-1 through 35-4, and 954-440-55-1 through 55-4 to eliminate the inconsistency between the guidance on health care entities and the proposed guidance on the net contract position.

Codification Subtopic	Description of proposed amendment
958-720 <i>Not-for-Profit Entities—Other Expenses</i>	Supersede paragraph 958-720-25-8 to eliminate the inconsistency between that paragraph and the proposed guidance.
970-10 <i>Real Estate—General—Overall</i>	Supersede the last sentence in paragraph 970-10-05-1, paragraph 970-10-05-2(h), and paragraph 970-10-15-10. Amend paragraph 970-10-15-9 to reflect the withdrawal of Subtopic 970-605.
970-323 <i>Real Estate—General—Investments—Equity Method and Joint Ventures</i>	Amend paragraph 970-323-30-3 to reflect the withdrawal of Subtopic 360-20.
970-470 <i>Real Estate—General—Debt</i>	Supersede paragraph 970-470-25-5 to reflect the withdrawal of Subtopic 974-605.
978-10 <i>Real Estate—Time-Sharing Activities—Overall</i>	Supersede the last sentence in paragraphs 978-10-05-1, 978-10-05-2(g), and 978-10-05-4. Supersede paragraph 978-10-15-4 to reflect the withdrawal of Subtopic 360-20.
978-330 <i>Real Estate—Time-Sharing Activities—Inventory</i>	Amend paragraphs 978-330-15-3 through 15-4 to reflect the withdrawal of guidance in Subtopic 360-20. Amend paragraphs 978-330-30-1 and 978-330-35-1 through 35-4 and supersede paragraphs 978-330-30-2 and 978-330-50-1 to reflect the withdrawal of Subtopic 978-605.

Codification Subtopic	Description of proposed amendment
978-720 <i>Real Estate—Time-Sharing Activities—Other Expenses</i>	Amend paragraph 978-720-25-1 and supersede paragraph 978-720-25-2 to require the recognition of all selling and marketing costs as expenses when incurred. Amend paragraph 978-720-25-3 to reflect the withdrawal of Subtopic 978-340.
980-350 <i>Regulated Operations—Intangibles—Goodwill and Other</i>	Supersede paragraph 980-350-35-5 to reflect the withdrawal of recognition guidance in Subtopic 980-605.
985-10 <i>Software—Overall</i>	Supersede paragraph 985-10-05-1(e) to reflect withdrawal of Subtopic 985-605. Amend paragraph 985-10-15-3 to reflect the withdrawal of Subtopic 605-35 and 985-605.
985-20 <i>Software—Costs of Software to Be Sold, Leased, or Marketed</i>	Amend paragraph 985-20-15-3 to reflect the withdrawal of Subtopic 605-35. Supersede paragraph 985-20-60-3 to reflect the withdrawal of Subtopic 985-605.
840-10 <i>Leases—Overall</i> 840-30 <i>Leases—Capital Leases</i>	Amend to conform with the Board's decision to supersede the guidance on real estate sales in Subtopic 360-20. Additional amendments will be considered as part of the Board's ongoing Leases project.

Codification Subtopic	Description of proposed amendment
840-40 <i>Leases— Sale- Leaseback Transactions</i>	Amend to conform with the Board's decision to supersede the guidance on real estate sales in Subtopic 360-20. Additional amendments will be considered as part of the Board's ongoing Leases project.
980-340 <i>Regulated Operations— Other Assets and Deferred Costs</i>	

The following Master Glossary terms would be superseded and disassociated from all Subtopics:

Affinity Program	Air Cargo
Airbill	Assumption
Authorization Code	Bargain Purchase
Breakage	Buydowns
Consideration	Continuing Investments
Contractor	Cooperative Advertising
Core Software	Cost-Plus-Award-Fee Contract
Cost-Plus-Incentive-Fee Contracts (Incentive Based on Cost)	Cost-Plus-Incentive-Fee Contracts (Incentive Based on Performance)
Cost-Sharing Contract	Cost-Type Contracts
Cost-Without-Fee Contract	Cross-Collateralized
Deferment	Delivery
Deposit Method	Direct Selling Costs
Downgrade	Enhancement
Extended Warranty	Fare
Firm Fixed-Price Contract	Fixed Fee
Fixed-Price Contract Providing for Firm Target Cost Incentives	Fixed-Price Contract Providing for Performance Incentives
Fixed-Price Contract Providing for Prospective Periodic Redetermination of Price	Fixed-Price Contract Providing for Retroactive Redetermination of Price
Fixed-Price Contract Providing for Successive Target Cost Incentives	Fixed-Price Contract with Economic Price Adjustment
Fixed-Price Contracts	Fixed-Price Level-of-Effort Term

	Contract
Flip Transactions	Front-End Sales Fee
Full Accrual Method	Half Turn
Hosting Arrangement	Incentive
Independent Third Party	Inducement
Initial Franchise Fee	Initial Services
Installment Method	Integral Equipment
Investor Notes	Licensing
Lifted Flight Coupon	Milestone*
Mini-Vacation	Off-the-Shelf Software
On-Line Lifts	On-Line Sale and Off-Line Sale
Other than Retail Land Sales	OTRLS
Ownership Interests	Partnership Notes
PCS	Percentage-of-Completion Method
Planned Amenities	Platform
Platform Transfer Right	Postcontract Customer Support
Product Maintenance Contracts	Profit Center
Promised Amenities	Reduced Profit Method
Reload	Rescission
Retrospective Insurance Arrangement	Revenue Passenger Mile
Right-to-Use	Round Turn
RPM	RTU
Sales Value	Sampler Program
Separately Priced Contracts	Site License
Slotting Fees	Street Date
Syndication Fees	Time-and-Material Contracts
Uncollectibility	Unit
Unit-Price Contracts	Upgrade Right
Upgrade Transaction	User
Vacation Club	Vendor
When-and-If-Available	Win
* Both instances of this term would be superseded and disassociated from all Subtopics.	

The terms in the following table also would be superseded and disassociated from all Subtopics. The definitions of the terms to be superseded are included in the table below to distinguish the defined term from other instances of the same term in the Master Glossary.

Continuing Involvement	<p>A situation in which the seller has not transferred substantially all of the benefits and risks incident to the ownership of real estate. Benefits include but are not limited to:</p> <ul style="list-style-type: none"> a. The right to occupy the property b. The transferability of the time-sharing interval without restrictions from the seller c. The right to insurance proceeds and condemnation awards d. The right to participate in making decisions regarding management of the property e. The control over rental of the time-sharing interval f. The right to any increase in the value of the time-sharing interval. <p>Risks include but are not limited to:</p> <ul style="list-style-type: none"> a. The responsibility for payment of applicable taxes, repairs, utilities, maintenance, insurance, and improvements b. The responsibility for management of the property c. Legal liabilities d. Setting aside of replacement reserves e. Casualty losses f. Exposure to any decrease in the value of the time-sharing interval. <p>In time-sharing transactions, it is common for certain of the benefits and risks to be transferred to an owners association or similar entity that acts on behalf of the owners of time-sharing intervals. See paragraphs 978-605-55-2 through 55-30.</p>
Cost Recovery Method	<p>Under the cost recovery method, no profit is recognized until cash payments by the buyer, including principal and interest on debt due to the seller and on existing debt assumed by the buyer, exceed the seller's cost of the property sold.</p>

Customer	A reseller or a consumer, either an individual or a business that purchases a vendor's products or services for end use rather than for resale. This definition is consistent with paragraph 280-10-50-42, which states that a group of entities known to a reporting entity to be under common control shall be considered as a single customer, and the federal government, a state government, a local government (for example, a county or municipality), or a foreign government each shall be considered as a single customer. Customer includes any purchaser of the vendor's products at any point along the distribution chain, regardless of whether the purchaser acquires the vendor's products directly or indirectly (for example, from a distributor) from the vendor. For example, a vendor may sell its products to a distributor who in turn resells the products to a retailer. The retailer in that example is a customer of the vendor.
Distributor	An entity or individual that owns or holds the rights to distribute films. The definition of distributor of a film does not include, for example, those entities that function solely as broadcasters, retail outlets (such as video stores), or movie theaters.
Modification	A change in the terms of the financing agreement between buyer and seller, typically to accommodate a situation in which the buyer is unable to meet his or her original contractual payment obligations.
Reseller	An entity licensed by a software vendor to market the vendor's software to users or other resellers. Licensing agreements with resellers typically include arrangements to sublicense, reproduce, or distribute software. Resellers may be distributors of software, hardware, or turnkey systems, or they may be other entities that include software with the products or services they sell.
Revenue	Revenue earned by an entity from its direct distribution, exploitation, or licensing of a film, before deduction for any of the entity's direct costs of distribution. For markets and territories in which an entity's fully or jointly-owned films are distributed by third parties, revenue is the net amounts payable to the entity by third party distributors. Revenue is reduced by appropriate allowances, estimated returns, price concessions, or similar adjustments, as applicable.

Upgrade	An improvement to an existing product that is intended to extend the life or improve significantly the marketability of the original product through added functionality, enhanced performance, or both. The terms upgrade and enhancement are used interchangeably to describe improvements to software products; however, in different segments of the software industry, those terms may connote different levels of packaging or improvements. This definition does not include platform-transfer rights.
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The term *Cash Consideration* would be superseded for Subtopic 605-50 only. The term would remain in the Master Glossary and would remain linked to other Subtopics.