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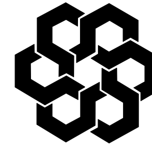

International Accounting Standards Board

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These notes are based on the staff papers prepared for the IASB and FASB. Paragraph numbers correspond to paragraph numbers used in the joint IASB-FASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IASB/FASB Meeting:	**22 October 2007, Norwalk**
Project:	**Revenue Recognition**
Subject:	**Measurement model summary (Agenda paper 5B)**

INTRODUCTION

Overview

1. In this model, revenue arises from recognising and explicitly measuring increases in specified assets and decreases in specified liabilities, rather than from a separate evaluation of how much performance occurred in a period. In other words, the amount of revenue to be recognised is determined by considering how much assets and liabilities change in a period. Because the model is predicated on explicit measurements of the assets and liabilities, it is described as the *measurement model*.

2. The specified assets and liabilities in this model are those that arise directly from enforceable contracts with customers. A contract can be either an asset or a liability to the entity, depending on the remaining unperformed rights and

obligations in the contract. A contract would be an asset (a contract asset) to the entity if the remaining unperformed rights exceed the remaining unperformed obligations. A contract would be a liability (a contract liability) to the entity if the remaining unperformed obligations exceed the remaining unperformed rights. *[Paragraphs 10–20]*

3. To measure the contract, the underlying rights and obligations in the contract are measured at their current exit price. This is the price that a market participant would pay (or require) to obtain (or assume) the remaining unperformed rights and obligations in the contract. The contract is measured this way at inception and subsequently. *[Paragraphs 21–28]*

4. Because the model focuses on the contract asset and liability, revenue is defined as an *increase* in a contract asset or a *decrease* in a contract liability. *[Paragraph 7]* Hence, revenue is *recognised* when:

   - an entity obtains a contract in which the underlying rights exceed the underlying obligations (because this would result in a new contract asset). *[Paragraphs 32–35]*

   - the entity subsequently satisfies its obligations in the contract by providing goods or services to the customer (because this would either increase a contract asset or decrease a contract liability). *[Paragraphs 36–38]*

5. The *amount* of revenue that is recognised is derived from the *increase* in the exit price of the contract asset or *decrease* in the exit price of the contract liability. *[Paragraph 39]*

A cautionary note

6. In illustrating the measurement model, simple examples are often used. However, it is important to note that if this model was adopted in practice, it would not alter the current accounting for many straightforward revenue transactions. For instance:

   - the model would not affect many point-of-sale contracts unless those contracts result in material obligations to customers that are not satisfied at the point of sale, such as return rights or warranties;

   - no revenue would be recognised until the entity had an enforceable contract. Hence, in the case of an executory contract that can be cancelled without penalty by either party before the entity performs, no assets or liabilities would be recognised, and, thus, no revenue would be recognised either.

WHAT IS REVENUE?

7. **Revenue is an *increase* in a contract asset or a *decrease* in a contract liability that results from (a) obtaining an enforceable contract with a customer to provide goods and services and (b) providing those goods and services to the customer.**

8. This definition of revenue is linked to changes in a narrow set of assets and liabilities: those arising directly from an enforceable contract with a customer to provide goods and services. These assets and liabilities are discussed below in paragraphs 10–20. Revenue is not affected by changes in assets such as inventory. Said simply, revenue reflects the increase in the entity's net position in an enforceable contract with a customer from obtaining that contract and subsequently providing goods and services to customers.

9. Goods and services are the items, tangible or intangible, that are produced or purchased by the entity for the purpose of sale or resale. Only contracts for the sale of such goods and services give rise to revenues. For instance, the sale of an item of plant or equipment that was held for use by the entity in the production of goods and services would not give rise to revenue.

HOW ASSETS OR LIABILITIES ARISE FROM AN ENFORCEABLE CONTRACT

10. When an entity enters into an enforceable contract with a customer, it exchanges promises with the customer. The promises impose *obligations* on the entity to transfer economic resources (in the form of goods and services) to a customer and convey *rights* to receive consideration from the customer in exchange.

11. The rights and obligations in the contract are inextricably linked because neither would be enforced without the other also being enforced. Some argue that those rights and obligations separately give rise to assets and liabilities, but they might present those assets and liabilities net in the statement of financial position. Others argue that the combination of the rights and obligations give rise to a single (ie net) asset or liability. This model treats the remaining unperformed contractual rights and obligations in the contract as the unit of account. **Hence, an entity recognises and measures either a contract asset or a contract liability. This asset or liability reflects the entity's net position in the contract with respect to the remaining unperformed rights and obligations in the contract.**

12. Accordingly, if the customer performs first by prepaying in full, then the entity has a contract that is a liability to it. This is because it only has contractual obligations remaining. In this case, as the entity satisfies its obligations by transferring economic resources to the customer, the contract liability *decreases.* In other words, the entity's net position in the contract *increases*.

> Suppose Engineering Co enters into a contract to deliver and install a machine. If the customer prepays, then immediately after contract inception Engineering Co has no remaining contractual rights. Therefore, the remaining unperformed contractual obligations give rise to a contract liability.
>
> After transferring the machine to the customer, Engineering Co's remaining unperformed obligations have decreased, because it needs only to install the machine. Therefore, the contract liability decreases, ie Engineering Co's net position in the contract increases.

13. If the customer does not prepay, then the remaining unperformed rights and obligations may result in the entity having a contract that is an asset or a liability to it. This will in part depend on the measurement of those rights and obligations (see paragraphs 21–28). In this case, as the entity satisfies its obligations, the asset will *increase* or the liability decrease (or the contract that was a liability will become an asset). This is because the rights remain unchanged but the obligations have decreased. In other words, the entity's net position in the contract *increases*.

> Suppose that in the above example payment is due on completion of the installation of the machine. In this case, on contract inception Engineering Co has both remaining unperformed rights and obligations. Suppose that the combination of these rights and obligations initially results in a contract asset, because the value of the rights is greater than the obligations.
>
> After transferring the machine to the customer, the remaining unperformed rights in the contract remain unchanged. However, Engineering Co's remaining unperformed obligations have decreased, because it needs only to install the machine. Therefore, the contract asset (which is the combination of the remaining unperformed rights and obligations) increases. As in the above example, Engineering Co's net position in the contract increases.

Relationship of the contract asset or liability to work in progress or inventory

14. The contract asset or liability arising from the remaining contractual rights and obligations is separate and distinct from any underlying assets to be sacrificed by the entity and transferred to the customer (eg an item of inventory). Hence it is not the *production* of goods and services that results in the satisfaction of an obligation; rather it is the *transfer* of those goods and services to the customer.

15. Therefore, creating an asset (eg manufacturing a good) for eventual transfer to a customer does not change the contractual rights and obligations and hence does not result in a change in the contract asset or liability. The contract asset or liability changes only when the underlying rights and obligations change.

> Suppose that on 1 May Engineering Co enters into a contract with a customer for the provision of a machine. The contract specifies that the machine will be transferred to the customer on 1 August, which is when payment is due. Engineering Co manufactures the machines to fulfil specific customer orders, and has partly completed the manufacturing on 30 June.
>
> On 30 June, Engineering Co has:
>
> - a *contract asset* from its remaining unperformed rights and obligations in the contract
> - an inventory asset in the process of production.
>
> Between 1 May and 1 August, there is no change in the remaining unperformed rights and obligations in the contract. This is because the output from entity's manufacturing process does not transfer to the customer and therefore satisfy the entity's obligation until 1 August.

16. In some cases, assets transfer to the customer throughout the production process so that the contractual obligation is satisfied continuously.

> Suppose that on 1 May Builder enters into a contract to build an extension to a building on the customer's land. The contract is expected to be completed on 30 September. The customer is required to prepay.
>
> On 30 June, Builder has:
>
> - a *contract liability* from its remaining unperformed obligations in the contract.
>
> In this case the outputs from Builder's production processes are transferred continuously to the customer. This is because they become the customer's property as they are installed on its land. Hence the contractual obligation changes continuously. So in this example, the contract liability at 30 June arises from Builder's obligation to provide the *remaining* construction materials and services.

17. A prerequisite to implement this model will be guidance to assist entities in determining when contractual obligations are satisfied. This also will require guidance to specify when the entity should derecognise assets such as inventory. This is because in many cases obligations are satisfied by transferring recognised assets of the entity to the customer.

Which obligations are included in the contract asset or liability?

18. The obligations include *all* of the obligations to the customer that arise from entering into the contract. This includes explicitly stated obligations to transfer economic resources to the customer. It also includes those obligations stemming from the promises that are *implied* by the entity's customary business practices if

a court would enforce those promises. For instance, these may include obligations to accept returns that are not required under the explicit terms of the contract.

19. Obligations to transfer economic resources to customers include obligations that require the entity to stand ready to perform. For instance, an entity that is providing a guarantee on a loan is providing a service to its customer for the duration of the guarantee, even though ultimately it might not have pay any cash if the borrower does not default.

20. Note that the contractual obligations include those obligations that are sometimes referred to as 'post-performance' obligations, such as a manufacturer's standard warranty and a return or cancellation right (ie the remaining obligations that an entity has after providing the main deliverable in the contract). In other words, all obligations (explicit or implicit) that would require the entity to transfer an economic resource to the customer as a result of entering into a contract with the customer would result in contractual obligations, the subsequent satisfaction of which would result in revenue.

HOW IS THE CONTRACT MEASURED?

21. The contract asset or liability (that is, the combination of the entity's remaining unperformed contractual rights and obligations) is measured at its current exit price. This is the amount that the entity would expect to receive or pay to transfer its remaining unperformed contractual rights and obligations to a market participant at the reporting date.

Why use a current exit price attribute?

22. A current exit price measure provides several benefits:

- It reflects the contractual rights and obligations that *remain* at the reporting date, no more or less. This is because an exit price is the price that the entity would have to pay another party to (a) take over full responsibility for performing all of the remaining obligations in the contract and (b) assume any remaining rights. The exit price notion therefore explicitly captures *all* remaining aspects of the contract, but no more and no less. In particular, the measurement does not implicitly capture cash flows that relate to activities that have already been completed.

- It reflects the circumstances that exist *on the reporting date*. A current exit price reflects these circumstances by depicting what the entity would have to pay market participants to assume the entity's remaining contractual rights and obligations at the reporting date. It therefore depicts how real world events (such as changes in prices and circumstances) affect the contract and reports the effects of those events when they occur. This provides relevant information about the amount and timing of the cash flows that will arise from the contract, which is particularly important in contracts of a longer duration.

In particular, it should provide more immediate reporting of loss-making or onerous contracts. This is because unfavourable changes in circumstance are reported immediately in profit or loss rather than in future periods.

- It would improve the *comparability* of reported information. A current exit price attribute reports economically similar obligations the same regardless of how the entity incurred those obligations. For instance, when an entity sells warranties to its own retail customers and also assumes identical warranties from other retailers for less money, a current exit price would measure those identical warranties at identical amounts.

- It explicitly requires a margin on *all* of the remaining obligations, including 'post-performance' obligations such as a return right, because a market participant would require a margin for fulfilling an obligation. Therefore (assuming the contract is profitable) *profit* is reported over the entire duration of the contract (and not, for instance, just on delivery of the main deliverable in the contract).

- Although an entity may not intend (or may not be able) to transfer the contract to a third party, a current exit price attribute provides a clear *objective* for measuring the rights and obligations that is based on economic attributes of those rights and obligations. Therefore, a current exit price attribute makes it easier to answer the question 'how much revenue (and profit) to recognise' by explicitly determining how much the asset or liability has actually changed in the period (particularly in contracts in which obligations are satisfied over time rather than discretely).

23. The above measurement approach treats the transaction price as an input into the measurement of the *rights* in the contract asset (or liability). This transaction price does not override the determination of the price a market participant would charge to assume the remaining rights and obligations in the contract. Two potential drawbacks about this measurement approach should be noted:

- It relies on a complete identification of all of the obligations in the contract. This is because if obligations that are present in the contract are not identified, they obviously will not be included in the measurement. This will therefore result in errors in the amount of revenue and profit recognised in profit or loss until such time as the omitted obligations are satisfied. In that regard, there is no 'cushion' against the possibility of omitting obligations on *initial* recognition of the contract asset or liability as there is with many current models.

- Any errors in the initial measurement of the contract will be reported in profit or loss. In other words, any revenue and profit or loss recognised on contract inception will include the effects of any errors in the initial measurement of the contract.

What is included in the measurement?

24. If the customer has prepaid in full, the measurement of the contract liability reflects the price that the entity would have to pay to transfer its remaining unperformed contractual obligations to a market participant at the reporting date. In other words, it is the amount that the entity would have to pay to lay off its obligations. Said simply, it is the price a market participant would charge to fulfil *all* of the remaining obligations in the contract with no anticipated payments from the customer. This price would reflect any express or implied rights of return and refund, allowances, rebates, discounts, and credits, etc.

25. The exit price will not typically be observable, so it will need to be estimated. The objective is to arrive at the price a market participant would charge, so inputs into the estimate should be consistent with that objective. However, an entity could use its own inputs if it has no evidence to suggest that they would be inconsistent with those that a market participant would use.

26. For example, in some cases, the amount may be derived from the price a subcontractor would currently charge for providing the goods and services underlying the obligations in the contract. This price would then need to be adjusted for the estimated amount a market participant would demand for managing the contract and the price for guaranteeing the performance of the subcontractor.

27. The exit price can also be estimated by using a 'building block' approach. In this approach, the price is estimated by considering the following three components:

    - the cash flows a market participant would expect to incur in providing all of the goods and services in the contract (ie the direct and indirect costs involved in fulfilling the obligations). When there is uncertainty about the cash flows, the estimate reflects the full range of possible outcomes, weighted by their respective probabilities.
    - the margins a market participant would demand for providing the goods and services (including the margin for bearing uncertainty).
    - the time value of money.

28. If the customer has not prepaid, the measurement of the contract asset (or liability) also reflects the enforceable expected cash flows from the customer, taking into account the effects of credit risk and the time value of money.

ACCOUNTING FOR THE CONTRACT WITH THE CUSTOMER

Before contract inception

29. Revenues cannot arise before a contract with a customer exists.

30. This may seem self-evident, but it is important to emphasise that under the definition in paragraph 7 above, revenues could not arise until a contract, which by definition is enforceable, exists. Before a contract exists, the entity does not have any contractual rights or contractual obligations. It is these contractual rights and obligations that are fundamental to the existence of contract assets and liabilities and hence revenue.

At contract inception

31. When an entity becomes party to a contract with a customer to provide goods and services, the entity recognises a contract asset or a contract liability from the combination of its rights and obligations in the contract.

32. If the entity recognises a contract asset (because the exit price of the underlying rights exceeds that of the underlying obligations), that increase in contract assets is recognised as revenue. If the entity recognises a contract liability (because the exit price of the underlying obligations exceeds that of the underlying rights), that increase in contract liabilities is recognised as a loss.

33. In a contract in which the customer pays in advance in full, immediately after contract inception, the rights are satisfied, but obligations still exist. Hence, the entity's net position in the contract immediately becomes a liability. Therefore, the amount of any revenue to be recognised at contract inception can be determined as the excess of the cash (or other consideration) obtained from the rights in the contract over the current exit price of the entity's contract liability. Conversely, if the exit price of the contract liability is more than the cash (or other consideration) obtained from the rights in the contract, the entity recognises the excess as a loss.

34. Revenue recognised at contract inception is the revenue that arises from obtaining a contract with a customer. This revenue does not necessarily result in reporting a corresponding amount of *profit*. This is because the entity will have incurred expenses in obtaining the contract (although some of these may have been recognised in prior reporting periods). Note that in this model there is no need to defer pre-contract expenses such as sales commissions or other direct costs of obtaining a contract. This is because some revenue would potentially be recorded at contract inception.

35. **Recognising the value attributable to obtaining the contract does not mean that the entire profit expected from the contract is recognised at contract inception. Profit that a market participant would require for providing the goods and services in the contract will be recognised only as those goods and services are provided.** Put another way, the revenue that is recognised at contract inception reflects the fact that if the contract was immediately transferred to a market participant, that market participant would not need to obtain the customer; it would need only to fulfil the contract.

> Suppose Retailer enters into an enforceable contract with a customer on 30 June for the sale of a good for CU150. The customer prepays and the good will be provided to the customer on 10 July.
>
> All things being equal Retailer would expect to pay less than CU150 at 30 June to transfer the contract liability to a market participant. This is because Retailer incurs expenses in obtaining the contract, ie all of the (direct and indirect) expenses associated with its selling activities (sales commission, staff wages, rent of retail facilities, etc). Retailer implicitly charges the customer for *all* of these activities. In other words, the customer pays for more than just the good itself. Therefore Retailer would expect to be compensated by the market participant for these activities if it transferred its contractual obligations. And the market participant would be prepared to compensate Retailer because it would not need to incur those costs itself: the customer is in place, it would only need to fulfil all of the contractual obligations.

After contract inception

Changes in the contract from providing goods and services

36. Revenue is recognised after contract inception as the entity satisfies the obligations in the contract with the customer, thus increasing the contract asset or decreasing the contract liability.

37. If the customer has prepaid, the contract liability decreases as the entity satisfies the obligations in the contract by providing goods and services to the customer. This is because, all things being equal, as the entity satisfies its obligations, the price that the entity would have to pay a market participant to assume the remaining unperformed obligations in the contract would decrease. The resulting decrease in the contract liability meets the definition of revenue.

> Suppose Engineering Co enters into a contract to deliver and install a machine. The customer prepays the contract price of CU1,000. Immediately after contract inception the exit price of the contract liability is CU900 and hence revenue of CU100 is recognised.
>
> Suppose that after transferring the machine to the customer, the exit price of Engineering Co's contract liability decreases to CU200, representing the amount a market participant would charge to install the machine. The decrease in the contract liability of CU700 (ie CU900 – CU200) is recognised as revenue.

38. If the customer has not prepaid, the contract asset increases as the entity satisfies the obligations in the contract by providing goods and services to the customer. This is because, all things being equal, as the entity satisfies its obligations, the price that the entity would expect to receive from a market participant to transfer

the remaining unperformed rights and obligations in the contract would increase. The resulting increase in the contract asset meets the definition of revenue.

> Suppose that in the above example payment is due on completion of the installation of the machine. The exit price of the contract asset on inception is CU100 and hence revenue of CU100 is recognised.
>
> Suppose that after transferring the machine to the customer, the exit price of Engineering Co's contract asset increases to CU800, representing the amount a market participant would pay for the customer's promise of CU1,000 less the amount it would charge to install the machine of CU200. The increase in the contract asset of CU700 (ie CU800 – CU100) is recognised as revenue.

39. The amount of revenue recognised is derived from the increase in the exit price of the contract asset or the decrease in the exit price of the contract liability (or combination of the two). Revenue therefore reflects the value of the goods and services that have been provided to the customer at the date they are provided.

Non-performance changes in the contract

40. **Changes in the exit price of the contract asset or liability for reasons other than the entity providing goods and services to the customer are reported outside of revenue.**

41. At each reporting date, the contract asset or liability is measured at its current exit price. This measure can change for reasons other than the entity providing goods and services to the customer (ie satisfying the obligations). For instance, the exit price of the contract asset or liability may change because of a change in the price of the underlying goods and services yet to be provided to the customer. To assist users in understanding the reasons for changes in the exit price of contract assets and liabilities, such changes are reported outside of revenue.

> Suppose Retailer enters into a contract with a customer to provide a widget in three months time for which the customer prepays in full CU100. Suppose that the initial measurement of the contract liability is CU90 and hence revenue of CU10 (ie CU100 – CU90) is recognised.
>
> Suppose that after one month there is an increase in the price of widgets and that as a result, a market participant would now require CU95 to assume Retailer's obligation to provide a widget. Retailer increases the contract liability to CU95 and recognises the resulting loss of CU5 in profit or loss outside of revenue.
>
> When Retailer satisfies its obligation by providing the widget to the customer, it extinguishes its contract liability. The resulting decrease in the contract liability of CU95 is recognised as revenue. This revenue reflects the value of the good being provided to the customer at the date that it is provided.

> Note that in this example because the amount of revenue was derived from the decrease in the exit price of the contract liability, the total amount of revenue recognised over the duration of the contract was CU105 (ie CU10 + CU95), which is greater than the payment actually received from the customer.

42. There are a number of options for displaying the changes in the contract asset and liability in the financial statements. Some of these display options can accommodate reporting an additional revenue line that reports the amount of the customer consideration as revenue. However, discussion and illustration of these options are outside the scope of this summary.

ACCOUNTING FOR A BROADER SET OF ASSETS AND LIABILITIES

43. The revenue model described above only accounts for a narrow set of assets and liabilities, namely those that arise from an enforceable contract with a customer. However, in some cases, the profit or loss (and statement of financial position) that results from such a narrow focus on the contract might fail to faithfully represent the economic circumstances of an entity. There are two main situations in which this might occur.

Accounting mismatches arising in profit or loss

44. After contract inception, but before fulfilment of the contract, the market price of a contractual obligation to provide a good to a customer may increase. This will decrease (increase) the measurement of the contract asset (liability) and result in the recognition of a contract loss. If the entity has already acquired or manufactured the good that will be used to satisfy the obligation (thereby having effectively hedged its position), but this good is not remeasured to reflect its current value, then recognising the increased market price of the obligation will result in an incomplete and potentially misleading depiction of how the price change has affected all the entity's assets and liabilities.

> Suppose Oil Co enters a fixed-price contract on 1 January with a customer to deliver 1000 gallons of oil in four equal instalments starting on 31 March. Suppose the customer pays in full in advance and Oil Co recognises a contract liability of CU3,000. Oil Co purchased all of the oil required to fulfil this contract on 1 January and measures its oil inventory at cost.
>
> On 1 March 2007, the price of oil increases by 10%. Suppose that this increase in the price of oil results in the exit price of the contract liability increasing to CU3,300 and therefore that Oil Co recognises a contract loss of CU300. If Oil Co does not reflect any corresponding increase in the carrying amount of its oil inventory, then profit or loss depicts Oil Co as if it was economically identical to an entity that had not obtained any oil to fulfil the contract. In other words, it depicts Oil Co as if it was fully exposed in its contract to changes in market prices of oil.

Incomplete depiction of the changes in the entity's assets and liabilities throughout the contract

45. An entity may create an asset under an enforceable contract for eventual transfer to the customer. In such a contract, until the asset (eg an item of inventory) is transferred to the customer, there will be no change in the entity's contractual obligation and, hence, no revenue will arise. Furthermore, if the asset is measured at accumulated cost, profit or loss will not reflect any increase in the entity's assets from *creating* the asset until it is transferred to the customer. Hence, profit or loss may give an incomplete depiction of the changes in the entity's assets and liabilities *throughout* the contract.

> Homebuilder is developing an estate of 10 houses. On 31 March 2007, it enters into a contract with a customer for the sale of House 2 of the development for the fixed price of CU250,000. At the time the contract is entered into, Homebuilder has not commenced work on House 2 (ie the house is sold to the customer 'off plan').
>
> On entering into the contract the customer pays Homebuilder a non-refundable deposit of CU25,000. The remaining amount of the consideration (CU225,000) is due when the Homebuilder transfers the completed house to the customer. Assume that this occurs on 31 January 2008. Assume that the exit price of the obligations on 31 March is CU240,000 and the initial measurement of the contract liability is CU15,000 (ie remaining rights of CU225,000 – remaining obligation of CU240,000).
>
> Following the principles in paragraphs 29–41, revenue of CU10,000 is recognised on 31 March (ie cash obtained of CU25,000 less contract liability incurred of CU15,000) and revenue of CU240,000 recognised on 31 January 2008.
>
> Between 31 March 2007 and 31 January 2008, Homebuilder recognises its costs in building House 2 as an item of inventory. House 2 is derecognised and an expense is recognised on 31 March 2008. Homebuilder's margin attributable to building House 2 is therefore not reported in profit or loss until 31 January 2008 when revenue and the building expenses are recognised in profit or loss.

46. Some think that the second situation described above highlights a weakness with the proposed definition of revenue in paragraph 7. They think that the source of an entity's revenues is the activities it undertakes in producing goods and services for customers rather than the contract itself. In other words revenue can *arise* from producing goods (eg from creating or enhancing inventory assets) even if this revenue is then precluded from *recognition* until a contract with a customer exists. They would therefore broaden the definition of revenue to capture increases (decreases) in assets (liabilities) that arise from the entire process of producing, selling, and delivering goods and services to customers.

47. To address these concerns, an alternative revenue model might focus on a broader set of assets and liabilities beyond those that arise directly from the contract alone. In particular, it also might include inventory assets (when they are the subject of a contract).

48. However, instead of broadening the definition of revenue, the model described in paragraphs 7–42 could be extended as follows. In a contract in which an entity is creating or enhancing an asset to fulfil contractual obligations, the increase in the exit price of that asset over the costs incurred in bringing the asset to its present location and condition could be reported in profit or loss as a separate component of income—production income. Hence, in such contracts an entity would recognise:

- *production income* as it created or enhanced assets
- *revenue* when it transferred those assets to the customer.

49. The profit attributable to creating or enhancing the asset would be recognised as those activities occur. The profit that would be recognised when revenue is recognised would relate only to contract completion activities (because the assets would be carried at their exit price at the date of transfer to the customer).

> Continuing with the Homebuilder example in paragraph 45.
>
> Suppose that Homebuilder incurs costs of CU175,000 in building House 2 and that the exit price of House 2 on completion is CU240,000. Applying paragraph 48, Homebuilder would recognise production income of CU65,000 (ie CU240,000 – CU175,000) over the period 31 March 2007 to 31 January 2008. And the carrying amount of House 2 immediately before the contract liability is satisfied would be CU240,000.
>
> When Homebuilder satisfies its obligation and recognises revenue of CU240,000 on 31 January 2008, it also derecognises House 2 and recognises a corresponding expense of CU240,000. Therefore no *margin* is reported on 31 January 2008 because the margin attributable to building House 2 was recognised as production income over the construction period.