Joint IASB-FASB Meeting
February 16, 2010

IASB agenda reference **5A**

FASB memo reference **127A**

Project **Revenue Recognition**

Topic **Scope**

Purpose

1. Board members are requested to decide on the scope of the proposed revenue recognition model.

Summary of recommendations

2. Staff recommends that:

   (a) performance obligations for the transfer of goods and services that are within the scope of other standards (ie standards other than IAS 11 *Construction Contracts*, IAS 18 *Revenue* and Topic 605 *Revenue Recognition* of the FASB Accounting Standards Codification) should be accounted for in accordance with those standards rather than under the proposed model. These performance obligations would include contractual obligations to provide the customer with financial instruments, insurance coverage, leased assets or guarantees.

   (b) at contract inception, the transaction price allocated to performance obligations should be equal to fair value if those performance obligations are required by other standards to be initially measured at fair value. The transaction price that remains should be allocated to all other performance obligations in the contract, including any other performance obligations that are within the scope of other standards,

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according to their relative standalone selling prices (which is consistent with the boards' previous decisions).

Background

3. The boards' objective for the revenue project has been to develop a single revenue recognition model using a recognition principle that can be applied consistently to various transactions. To achieve this objective, the discussion paper *Preliminary Views on Revenue Recognition in Contracts with Customers* proposed a model to recognise revenue arising from contracts with customers.
4. By scoping the project in this way, the boards have not attempted to develop a revenue recognition model that applies universally to all types of revenue. Attempting to do so may be difficult—if not impossible—to achieve. This was a point that some of the respondents to the discussion paper acknowledged. Instead, the model focuses on accounting for the most common types of revenue generating events, such as delivering or producing goods and rendering services. These events typically arise from contracts with customers, with the proposed model recognising revenue on the basis of increases in an entity's net contract position in the contract as a result of transferring goods or services to the customer.
5. In relation to the scope of the proposed model, the discussion paper mentioned that the boards would subsequently consider:
   (a) the implications of the proposed model for entities that recognise revenue or gains in the absence of a contract; and
   (b) whether any contracts with customer should be excluded from the proposed model.
6. This paper considers those issues.

Structure of the paper

7. The remainder of the paper is structured as follows:
   (a) Scope of the proposed model;

(b) Revenue arising in the absence of a contract with a customer;

(c) Contracts with customers within the scope of other standards; and

(d) Performance obligations within the scope of other standards.

Appendices A and B consider how the model would apply to contracts with customers that include financial instruments (Appendix A) and leases (Appendix B).

Scope of the proposed model

8. The proposed model accounts for contracts with customers. The definitions of a contract and a customer establish the scope of the model.

9. The definition of a *contract* proposed in the discussion paper was:

> A contract is an agreement between two or more parties that creates enforceable obligations.

10. The definition of a *customer* proposed in the discussion paper was:

> A customer is a party that has contracted with an entity to obtain an asset (such as a good or a service) that represents an output of the entity's ordinary activities.

11. IASB agenda paper 14A and FASB memo 119A, prepared for the July 2009 joint meeting, summarised the views of respondents on those definitions. Respondents generally agreed with the notions underpinning the definitions. Some respondents commented on the wording used in the definitions, noting that these comments sought to clarify the meaning of the definitions rather than narrow or broaden the scope of the proposed model.

12. The staff are not recommending any changes to those definitions. However, the staff will consider the feedback received from respondents during the drafting of the exposure draft, and will also consider whether these definitions are consistent with definitions being developed in other projects.

Revenue arising in the absence of a contract with a customer

13. Because the existence of a contract with a customer defines the scope of the proposed model, revenue that does not arise from a contract with a customer is outside of scope. The staff notes that revenue that is outside of the scope of the proposed model can still be classified as 'revenue'. Revenue is currently defined in the FASB conceptual framework and in IAS 18.[1] The boards will reconsider the definition of revenue in the elements and recognition phase of their conceptual framework project. In contrast, the revenue recognition project is only accounting for a sub-class of revenue—revenue from contracts with customers.

14. The types of revenue (or gains) that can arise without a contract with a customer include:

    (a) revenue (or gains) from the remeasurement of assets if the measurement change is recognised in profit or loss. Examples include changes in the value of biological assets, investment properties and the inventory of commodity broker-traders.

    (b) revenue from transactions with partners in a joint arrangement or from transactions with participants in a collaborative arrangement. However, in either of these cases, transactions between partners or between collaborators will be within the scope of the proposed revenue recognition model if the other party meets the definition of a customer in relation to the transaction in question. Entities will need to exercise judgement to determine whether the other party is a customer based on the specific facts and circumstances of the transaction. The

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[1] 'Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.'
[FASB Concepts Statement No. 6 *Elements of Financial Statements*, paragraph 78]

'Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.'
[IAS 18, paragraph 7]

collaborative research and development efforts between biotechnology companies and pharmaceutical companies are example of this type of transaction. Another example relates to joint venture arrangements in the oil and gas industry where the partners may deal between themselves to settle any differences between their proportionate entitlement to oil volumes that has been extracted and the oil volumes they physically received to sell to their customers.[2]

(c) revenue from transactions with owners in their capacity as owners (eg dividends received); and

(d) revenue from non-contractual royalties. This means that accounting for revenue arising from royalties imposed by legislation will be outside the scope of the proposed model. In most cases, the recipients of that royalty revenue will be public sector entities such as governments and government agencies. The boards' responsibilities do not extend to developing specific accounting requirements for those entities (although some jurisdictions that adopt IFRSs for not-for-profit and public sector entities as well as for private sector entities). However, royalties imposed by legislation are also received by entities in the private sector. One example relates to copyright legislation that requires the payment of royalties to the rights holder when the copyrighted work (eg music) is reproduced.

15. Existing revenue standards (ie IAS 11, IAS 18 and Topic 605) contain guidance for accounting for some cases when revenue arises in the absence of a contract with a customer. Because the staff's working assumption is that the proposed model will replace most of the guidance in these standards, some of that revenue guidance will need to be retained to replicate current accounting outcomes for transactions that are outside of the scope of the proposed model. The staff thinks that it is outside the scope of this project to change accounting outcomes for transactions or events that are not within the scope of the proposed model.

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[2] This difference between the partner's entitlement volumes and their sales volumes is commonly referred to as an underlift or overlift.

16. The staff will address the relocation of this guidance in the consequential amendment process. The guidance to be relocated includes the following:

    (a) In IFRSs, the only existing revenue guidance that does not involve a contract with a customer and that needs to be retained relates to the recognition of dividend revenue and non-contractual royalties. This guidance is currently contained in IAS 18.

    (b) For US GAAP, the staff's review of Topic 605 is continuing. One example of guidance to be retained is Subtopic 605-40 *Revenue Recognition—Gains and Losses*, which relates to accounting for gains and losses on involuntary conversions of nonmonetary assets to monetary assets (eg from an insurance payout).[3] Another example is Subtopic 958-605 *Not-for-Profit Entities*.

17. The staff does not expect that the proposed model will affect the recognition of the other types of revenue listed in paragraph 14. This is because either non-revenue standards apply (ie standards other than IAS 11, IAS 18 and Topic 605) or no standard specifically applies to the transaction or event.

Contracts with customers within the scope of other standards

18. The discussion paper included in the scope of the proposed model all contracts with customers. Although the discussion paper did not propose limiting the application of the proposed model, the boards noted that the model might not necessarily provide useful information for:

    (a) 'financial instruments and some non-financial instrument contracts that would otherwise be in the scope of IAS 39 *Financial Instruments: Recognition and Measurement* and SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*';

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[3] Similar guidance exists in IFRS, but it is located in IAS 16 *Property, Plant and Equipment* rather than in a revenue standard.

(b) 'insurance contracts that are in the scope of IFRS 4 *Insurance Contracts* and SFAS 60 *Accounting and Reporting by Insurance Enterprises* (and other related US GAAP)'; and

(c) 'leasing contracts that are in the scope of IAS 17 *Leases* and SFAS 13 *Accounting for Leases* (and other related US GAAP)'.

19. Accordingly, this section considers whether the scope of the proposed model should include contracts with customers where the performance obligations to transfer goods or services are within the scope of other standards.

Types of contracts that would be outside scope

20. The staff's view is that, consistent with existing standards, the revenue recognition standard should apply to contracts with customers unless another standard specifically applies to the contract or to performance obligations within the contract. In those cases, the specific standard should override the general standard.

21. As mentioned earlier, the staff envisages that the proposed model will supersede the revenue guidance relating to contracts with customers that is currently within the scope of:

(a) for IFRSs—IAS 18 and IAS 11; and

(b) for US GAAP—Topic 605 (with the exception of the revenue guidance for insurance contracts[4]).

22. Consequently, the scope of the proposed model would not include accounting for contracts with customers that are:

(a) financial instruments (and that are accounted for as financial instruments);

(b) insurance contracts; and

[4] Under US GAAP, revenue guidance for insurance contracts will be superseded by the Boards' new standard on insurance contracts. Under IFRSs, revenue guidance for insurance contracts is located in IFRS 4 *Insurance Contracts* rather than in the revenue standards.

(c) leases.

It would also not apply to liabilities arising from guarantees that are not accounted for as insurance contracts or financial instruments (eg guarantees within the scope of Topic 460 *Guarantees*).[5]

23. The staff thinks that excluding those contracts from the scope of the proposed model is appropriate either because the boards are addressing the accounting for those arrangements in other projects or because the primary focus of the existing guidance is to account for the liability rather than the revenue (eg guarantees).

24. The staff's views on scope are consistent with the views expressed by respondents, many of whom thought scope exclusions would be needed because applying the proposed model to these arrangements would not provide useful information. For example:

> We support the development of a model that can be applied to a broad range of performance obligations across all industries. However, the Boards may find that for some arrangements the general model does not result in decision-useful information and, if so, then those arrangements should be subject to a different recognition or measurement model (e.g., financial instruments). (CL #61, KPMG)

> We believe that the proposed model should apply to most contracts with customers. However, we recognise that the boards are currently working on a number of projects (e.g., leases and insurance) that involve contracts and transactions that may be similar to those addressed by the revenue discussion paper. We believe that, for conceptual and practical reasons, such contracts should be addressed within those projects. We believe it is also important that the boards ensure consistency in the treatment of economically similar transactions regardless of the project in which they are addressed. The fundamental principles in this discussion paper, such as control, should be aligned to the extent possible with similar concepts in other projects.
> (CL#68, PricewaterhouseCoopers)

25. Some may argue that excluding financial instruments, insurance, leasing and guarantee arrangements from the scope of the proposed model would continue

[5] In US GAAP, accounting for the guarantee liability is addressed in Topic 460 and guarantee fee revenue is addressed in Topic 605. Under the staff's view, the guidance on guarantee fee revenue would be replaced by the proposed model and the existing liability accounting in Topic 460 would remain.

the historically haphazard development of revenue recognition guidance for specific transactions or industries. However, it is evident from the boards' discussion on other projects that the proposed revenue recognition model is providing a framework for considering revenue issues in those projects. Any departure from the revenue recognition model in those projects is the result of the boards deciding to modify the basis for accounting for the contract with a customer to provide more relevant information about those arrangements. Furthermore, based on the boards' decisions on the leases project, the requirements being considered in accounting for lessors could be characterised as providing specific guidance on the application of the revenue recognition model to the lessor. This includes, for example, identifying the performance obligations within a lease and how and when those performance obligations are satisfied.

Types of contracts that would remain inside scope

26. A number of respondents, mainly from the construction industry, wanted the Boards to maintain a separate revenue recognition model for construction contracts. This reaction may be attributable to the perception within the construction industry that the proposed model would require completed contract accounting. More recently, representatives from the construction industry participating in the revenue workshops seemed less concerned with the proposed model after the staff clarified the intended meaning of control. (Those industry representatives still have some concerns with other features of the model relating to the accounting for costs and the affect on their reported margins if contract revenues are recognised on a different basis to contract costs.)

27. The staff recommends that construction contracts should remain within the scope of the proposed model. This is consistent with the boards' previous decisions when they considered the appropriateness of the model to construction contracts as part of their discussions on control. However, the staff notes that the boards will consider contract costs again at their March meeting and this could affect decisions on the scope of the proposed model.

Question 1: Scope of the proposed model
The staff recommends that performance obligations for the transfer of goods and services that are within the scope of other standards should be accounted for in accordance with those standards rather than under the proposed model. These performance obligations would include contractual obligations to provide the customer with financial instruments, insurance coverage, leased assets or guarantees. Do the boards agree?

Accounting for performance obligations within the scope of other standards

28. There will be contracts with some performance obligations that are within the scope of other standards and the remaining performance obligations within the scope of the proposed model. Consider, for example, a contract that grants a financial instrument to the customer and provides them with investment management services. The entity would apply financial instruments standards to the performance obligation to provide a financial instrument. It would apply the proposed revenue recognition model to the performance obligation to provide the service.

29. Similarly, existing standards acknowledge that different standards may apply to separate components of an arrangement. For example, in IFRSs, this is contemplated by IFRIC 4 *Determining whether an Arrangement contains a Lease*. In US GAAP, this is perhaps best illustrated by Subtopic 605-25 *Revenue Recognition—Multiple-Element Arrangements*, which states at paragraphs 605-25-15-3 and 15-3A:

> 15-3 A multiple-deliverable arrangement may be within the scope of another Codification Topic. Those Topics include all of the following:
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> a. For leases, see Topic 840.
>
> b. For franchisors, see Topic 952.

c. For property, plant, and equipment, see Topic 360; specifically, Subtopic 360-20.

d. For guarantees, see Topic 460.

e. For revenue recognition, see Topic 605; specifically, Subtopics 605-20 and 605-35.

f. For software, see Topic 985; specifically, Subtopic 985-605.

g. For entertainment—films, see Topic 926; specifically, Subtopic 926-605.

15-3A Those Topics may provide guidance with respect to whether and how to allocate consideration of a multiple-deliverable arrangement. Whether deliverables are within the scope of those other Topics is determined by the scope provisions of those Topics, without regard to the order of delivery of that item in the arrangement. …

30. Consequently, accounting for these types of contracts with customers requires an entity to:

    (a) identify separate performance obligations, and

    (b) allocate the transaction price to those separate performance obligations.

Identifying separate performance obligations

31. Because the revenue recognition model would apply generally, the staff thinks that other standards applying to specific transactions should identify the separate performance obligations within their scope. Consequently, the proposed revenue recognition model would apply to the remaining performance obligations that are not within the scope of other standards.

32. Most contracts with customers involve the transfer of goods and services that are negotiated together with a single commercial objective. Therefore, it is likely that the performance obligations within a contract will have interdependent prices[6] and hence, will not be eligible for treatment as separate contracts. So, for the purposes of assessing scope, the entire contract would

[6] This means that the cash flows relating to one performance obligation affect the cash flows for another performance obligation and vice versa.

either be inside or outside the proposed revenue recognition model. In deciding which standard should apply to that contract, the staff thinks that the standard most directly applicable to the substance and features of that bundle of performance obligations should apply. The scoping requirements of the other standards will help to determine which standard takes precedence more than one standard could apply.

33. Alternatively, interdependent performance obligations could be treated as separate units of accounting when assessing scope. The staff are not recommending this approach because the other standards may prescribe how to account for the interdependency. For instance, an insurance contract may contain an insurance component, a financial instruments component and a service component—all of which are interdependent. In January 2010, the insurance staff recommended that all interdependent performance obligations within an insurance contract should be accounted for in accordance with the insurance contracts standard.[7] The IASB tentatively agreed with the insurance staff recommendation. The FASB asked for further clarification on when performance obligations would be unbundled and how it relates to the definition of an insurance contract and the scope of the proposed insurance contracts standard. The insurance staff will present follow up papers on this topic to the boards at this meeting.

Allocation of transaction price

34. The proposed revenue recognition model allocates transaction price to performance obligations on the basis of relative standalone selling prices. The amount that is allocated becomes the initial measurement of those performance obligations for the proposed revenue recognition model. The following analysis considers whether an allocated amount is an appropriate initial measurement

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[7] The scope of the proposed insurance contracts standard has not yet been determined. The staff note that the proposed revenue recognition model would be expected to include within its scope any arrangements that meet the definition of an insurance contract but that the boards decide should be outside the scope of the insurance contracts standard. For instance, this might include accounting for road side assistance contracts.

basis for performance obligations that are to be accounted for under other standards.

35. The staff thinks that using an allocated amount as an initial measurement is appropriate for standards that prescribe an initial measurement basis equal to transaction price. This is the current proposal for measuring the lessor's performance obligation and the FASB's current proposals for the initial measurement of financial instruments measured at fair value with changes in fair value recognised in other comprehensive income and for financial instruments measured at amortised cost.

36. However, an allocated transaction price amount should not be used for those performance obligations that are initially measured at fair value under other standards. There are two reasons for this. First, it is outside the scope of the revenue recognition project to change existing requirements in the measurement of those liabilities arising from contracts with customers. These include the IASB's requirements for financial assets measured at amortised cost and the FASB's requirements for guarantees within the scope of FASB ASC Topic 460. Second, it would result in the day-2 gains or losses being recognised for those performance obligations that are measured at fair value each reporting period if the underlying item was remeasured from an allocated amount (in accordance with the revenue recognition model) to fair value (as per the specifically applicable standard).

37. In relation to contracts with customers that include performance obligations for insurance coverage, the transaction price allocated to the insurance performance obligations will be treated as the insurance premium. Measuring those performance obligations at an allocated amount is considered appropriate because the insurance contract model calibrates the current value of the insurance liability to the premium at initial recognition.

38. For these reasons, the staff recommends that, at contract inception, the transaction price allocated to performance obligations that are outside the scope of the proposed model should be equal to fair value if those performance obligations are required to be initially measured at fair value under those other

standards. The transaction price that remains should be allocated to all other performance obligations in the contract, including any other performance obligations that are within the scope of other standards, according to their relative standalone selling prices (which is consistent with the boards' previous decisions).

Question 2: Allocation of transaction price to performance obligations that are outside of scope
The staff recommends that, at contract inception, the transaction price allocated to performance obligations should be equal to fair value if those performance obligations are required by other standards to be initially measured at fair value. The transaction price that remains should be allocated to all other performance obligations in the contract, including any other performance obligations that are within the scope of other standards, according to their relative standalone selling prices (which is consistent with the boards' previous decisions). Do the boards agree?

Appendix A

Applying the model to financial instruments

A1. The illustrative examples accompanying IAS 18 *Revenue* refer to the accounting for financial services fees. The examples provide guidance on when to recognise these fees as revenue and when to include them in accounting for the corresponding financial instrument. The illustrative examples characterise financial services fees as falling into one of three categories:

(a) fees that are an integral part of the effective interest rate of a financial instrument;

(b) fees that are earned as services are provided; and

(c) fees that are earned on the execution of a significant act, such as placement fees for arranging a loan between a borrower and an investor.

A2. The staff's view, after considering all of these examples, is that the question of whether to account for financial services fees as a revenue item or a financial instruments item is most likely to arise in contracts that contain loan origination fees or loan commitment fees. The following paragraphs consider how to account for loan origination fees when applying the proposed revenue recognition model.

Loan origination fees

A3. Some loan agreements require a customer to pay fees either when applying for the loan or when the loan is established. These fees are often called loan origination fees. Origination fees can include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction.

A4. The rationale for charging origination fees can vary by entity and by loan product. For instance, the fees could represent a fee for a service provided to the customer, a recovery of the administration costs incurred by the entity in assessing whether the entity can lend money to the customer and/or in processing the loan, or a prepayment of interest so that the customer is charged a lower interest rate over the life of the loan.

Current developments

A5. Current developments in accounting for these fees is based on the requirements in the illustrative examples that accompany IAS 18 (as amended by IFRS 9 *Financial Instruments*) and by the FASB's tentative decisions in its accounting for financial instruments project. Based on these developments, loan origination fees are treated differently depending on the measurement basis applied to the financial instrument, as shown in the table below.

Financial instrument is measured at…	**Origination fees are…**
Fair value through profit or loss	recognised as revenue when the instrument is initially recognised
Fair value through other comprehensive income[8]	recognised in other comprehensive income and amortised to net income as a yield adjustment over the life of the related financial instrument
Amortised cost	recognised as an adjustment to the effective interest rate

No change to accounting outcomes

A6. The staff thinks that accounting for loan origination fees is principally a financial instruments issue because, as the table above shows, existing practice includes those fees in the calculation of the effective interest rate in particular circumstances. The staff is not recommending that this accounting should be

[8] This classification and treatment for financial services fees is based on tentative decisions made by FASB in its project on accounting for financial instruments.

revisited as part of the revenue recognition project. However, for IFRSs, a consequential amendment will be required to relocate the guidance on financial services fees from the illustrative examples accompanying IAS 18—most likely to IFRS 9. A corresponding consequential amendment is not required for US GAAP because the equivalent guidance is not located with other revenue recognition guidance in Topic 605; instead it is located in Topic 320 *Investments—Debt and Equity Securities*.

Applying the proposed model

A7. Under the proposed model, an entity must determine whether the financial services related to loan origination result from a separate performance obligation imposed by the loan contract. Typically, there are two factors to consider when making this assessment:

(a) whether the fees that are paid to the entity are refundable or non-refundable; and

(b) the time when those fees are paid—that is, whether the fees were paid when the customer submitted the application or when the customer accepted the entity's offer of a loan.

A8. Depending on the agreement, some fees that are paid when the customer applies for a loan may be refundable if either the loan application is not accepted by the entity or possibly even if the customer decides not to take out the loan. In either case, the staff thinks that the customer is not receiving a service from the entity and so no performance obligation exists. Instead, the entity is undertaking an internal activity to determine whether the customer is eligible for a loan in accordance with the entity's lending policies and criteria. The fee is also not being directly charged as a cost recovery mechanism because the entity will incur the costs to assess the application regardless of whether the entity provides the loan. It is possible that the entity may use the fees retained from loans that are accepted to offset the costs of assessing loan applications that are rejected or not taken up by the applicants. Nevertheless, the refundable nature of the agreement means that the entity is not provided a separate service to the customer under a contract. Therefore, the fee represents part of the revenue

stream associated with the loan contract—in other words, the fee is an integral part of the effective interest rate of the financial instrument.

A9. If the fees are non-refundable, the implication is that the entity is providing a service to the customer; otherwise why would the customer agree to pay the fee? The staff thinks that there is a performance obligation being provided in this case—the customer has engaged the entity to assess their eligibility for a loan and, if they are eligible, to grant them an option to take out the loan. The fact that mortgage brokers provide these services separately from a loan contract also provides evidence that non-refundable application fees are paid to provide the customer with a service.

A10. Logically, a contract with a customer to process a loan application must precede the loan contract with a customer. The proposed revenue recognition model has a contract combination principle whereby two or more contracts are treated as a single contract if the prices of those contracts are interdependent. As noted above, the fee charged for loan origination could be designed to achieve various objectives, such as to provide the customer with a lower interest rate because the fee includes an interest prepayment component. For this reason, the staff thinks that a contract for loan applications would typically be priced interdependently with the loan contract. Under the proposed model, the individual performance obligations within the combined contract, being the separate performance obligations for processing the loan application and then making the loan funds available, would be assessed to determine whether they are in the scope of the financial instruments standard or the revenue recognition model.

A11. The issue of refundability arises for only application fees. Fees paid on establishment of a loan would always be expected to be non-refundable because they are fees charged to the customer when the loan contract is established. The act of establishing a loan does not provide a service to the customer separate from the provision of loan funds. It is an activity that needs to be undertaken to allow the customer to access the funds. Consequently, as there is no separate performance obligation, the loan contract and establishment fee should be accounted for in accordance with the financial instruments standard.

How would the proposed model interact with the financial instruments standards?

A12. The above analysis reached the following conclusions about three basic scenarios for accounting for contract origination fees:

Scenario	**Is it a separate performance obligation?**
Refundable fees levied when the customer submits a loan application	No
Non-refundable fees when the customer submits a loan application	Yes, but the contract combination principle will apply to combine the loan application contract with the loan contract (assuming the loan application is successful)
Non-refundable fees when the loan is established	No

A13. As there is no separate performance obligation for the refundable loan application fees or the non-refundable loan establishment fees, those fees and the loan contract would be wholly within the scope of the financial instruments standard. The basis for accounting for the fees would be as per current developments—being that:

(a) the fee would be recognised as revenue when the loan contract is recognised if the loan contract is measured at fair value through profit or loss;

(b) the fee would be recognised in other comprehensive income and amortised to net income as a yield adjustment over the life of the related financial instrument; or

(c) the fee would be recognised as an adjustment to the effective interest rate.

A14. For the non-refundable loan application fees, the staff's view is that there would typically be an interdependence between the performance obligations for the loan application and for the subsequent loan contract performance obligation. In those circumstances, they should be treated as a single contract and accounted for under the same accounting standard. The financial instruments standard is the more specific standard and therefore both performance obligations would be

accounted for in accordance with those standards. This approach allows for practice based on the abovementioned current developments to continue for those fees, as noted in the previous paragraph. This means that, for example, the fee would be recognised as revenue when the loan contract is made if the entity measures the loan contract at fair value through profit or loss.

Appendix B

Applying the model to leases

B1. Many contracts with customers are likely to contain performance obligations to grant a customer the right to use an asset as well as to provide services to that customer. A simple example is a contract to provide the right to use a motor vehicle for 3 years (a lease) and to service the vehicle every 6 months (a service). However, there will be more complex situations where it may be unclear whether the contract contains only a lease, only a service agreement or contains both a lease and a service agreement. Examples where this uncertainty exists includes some take or pay contracts in the utilities industry whereby all, or almost all, of the output is produced for the customer.

B2. This uncertainty arises in existing practice as well, with IFRIC 4 and FASB ASC Topic 840 *Leases* requiring arrangements to be assessed to determine whether they contain a lease that should be recognised separately. The nature of these arrangements means that there may be interdependencies between any lease and service component such that the contract contains a single set of cashflows relating to the lease and the other contractual promises. Those standards require the entity to estimate the fair values of the lease and services and allocate the transaction price to both according to their relative values.

B3. Under the proposed model, the entity would need to determine whether the performance obligations in the contract with a customer relate to leases, services, or both. The authority for making this assessment will be the requirements in the leases standards; not the revenue recognition standard. The proposed revenue recognition model would apply to any performance obligations within the contract that are for services. The leases standards would apply to any performance obligations relating to the lease. The measurement of both sets of performance obligations would be based on an allocation of transaction price by relative standalone selling prices of the underlying goods and services.