Project **Revenue Recognition**

Topic **Background paper: summary of proposed model**

Introduction

1. This paper summarizes the revenue recognition model that the Boards are developing for contracts with customers. Although the model is still being developed, the staff thinks it is useful for the Boards to see how their tentative decisions to date (and potential decisions in coming months) fit together to form a single revenue recognition model.

2. The staff is in the process of analyzing existing revenue guidance for the purpose of determining how much implementation guidance is needed for the forthcoming Exposure Draft.

3. The staff highlights the following changes to how the model is being articulated:

   (a) **The model is organized as it might be in an Exposure Draft** (i.e. objective, scope, recognition, measurement, etc.).

   (b) **The terminology on contract segmentation reflects recent feedback received**—Many constituents (and some Board members) have expressed concerns with how the proposed model articulates contract segmentation. The staff thinks those concerns relate primarily to (a) confusion about the difference between identifying a separate contract and identifying a separate performance obligation, and (b) uncertainty about whether a good or service "could be sold separately" and, hence, would be accounted for separately in accordance with the proposed model.

To address issue (a), this summary of the model uses the term "contract segment" only when referring to a segment of a contract that should be accounted for as a *separate contract* in accordance with the proposed model (see paragraphs 17–20). To account for a contract segment as a separate contract, an entity must conclude that the prices of the goods or services in the contract are independent of the prices of the other goods or services in the contract. The revised wording focuses on that principle.

To address issue (b), this summary of the model eliminates the words "could be sold separately" and focuses on identifying performance obligations that should be accounted for separately because the underlying goods or services are *distinct* (see paragraph 31).

(c) **The indicators of control have been refined**—Many constituents (and some board members) have suggested combining some of the indicators of control to minimize the risk of an entity using the list of indicators as a checklist and overlooking the principle of determining when a good or service has been transferred. For example, the indicator "legal title" coincides with a customer's ability to sell an asset or pledge it as collateral. Hence, the staff has combined those three indicators into one.

In addition, the indicator referring to the customer's ongoing managerial involvement has been combined with the indicator that the customer has specified the design or function of the asset. Paragraph 37 lists the refined indicators of control.

(d) **The staff's proposed disclosure requirements are included—** Although the Boards have not yet decided on disclosure requirements for the Exposure Draft, the staff has included some proposed requirements to illustrate how they might be organized in the Exposure Draft.

4. This paper is organized as follows:

   (a) Overview and Background (paragraphs 6–8)

   (b) Objective (paragraph 9)

(c) Scope and Scope Exceptions (paragraphs 10–23)
   (i) Contracts with customers
   (ii) Identifying the contract
(d) Recognition (paragraphs 24–44)
   (i) Identifying performance obligations
   (ii) Satisfaction of performance obligations
   (iii) Continuous transfer of goods or services
(e) Initial Measurement (paragraphs 45–60)
   (i) Determining the transaction price
   (ii) Allocating the transaction price to performance obligations
(f) Subsequent Measurement (paragraphs 61–62)
   (i) Onerous performance obligations
(g) Presentation (paragraphs 63–64)
(h) Disclosure (paragraphs 65–76)
(i) Implementation guidance and illustrations (paragraphs 77–97)
(j) Glossary

5. Terms defined in the glossary are in *italics* the first time they appear. Paragraphs presented in **bold** type state the main principles.

Overview and Background

6. 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 *Revenue* paragraph 7).

7. This model specifies the accounting for revenue arising from contracts with customers. This model does not address revenue arising from other transactions or activities.

8. In this model, an entity recognizes revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration received in exchange for those goods or services. To apply this model, an entity would:

   (a) identify the contract with the customer,

   (b) identify the performance obligations in the contract,

   (c) determine and allocate the transaction price,

   (d) recognize revenue when performance obligations are satisfied.

Objective

9. The objective of this model is to establish principles for the accounting for revenue arising from a *contract* with a *customer* that will report relevant and useful information to users of financial statements for their assessment of the amount, timing and uncertainty of the entity’s future cash flows.

Scope and Scope Exceptions

Contracts with customers

10. This model applies to an entity’s contracts with customers.

11. This model does not apply to:

    (a) financial instrument contracts,

    (b) insurance contracts,

    (c) leasing contracts, and

    (d) nonmonetary exchanges entered into for the purpose of facilitating a sale to another party (e.g. a contract for an exchange of commodities such as oil or milk to fulfil demand on a timely basis in a specified location).

12. If a contract with a customer includes a *performance obligation* that is in the scope of another standard, an entity shall account for that performance obligation in accordance with the other standard. At contract inception, an entity shall allocate the *transaction price* to that performance obligation in the amount

equal to the initial measurement basis in accordance with the other standard. An entity shall allocate the remainder of the transaction price to the performance obligations in the scope of this model.

13. An entity shall apply this model consistently to contracts with similar characteristics and in similar circumstances.

Identifying the contract

14. **An entity shall apply the requirements of this model to each contract identified in accordance with paragraphs 15–23.**

15. Contracts can be written, verbal, or implied. Customary business practices and processes for establishing contracts with customers vary across legal jurisdictions, industries, entities, and may also vary within an entity (e.g. based on the class of customer or the nature of the promised goods or services). An entity shall consider those practices and processes in determining when a contract exists.

16. An entity shall apply the requirements of this model to a contract with a customer only if:

    (a) the contract has commercial substance,

    (b) the contract specifies the goods or services to be transferred,

    (c) the contract specifies the amount of consideration to be paid in exchange for those goods or services,

    (d) the contract specifies the manner and terms of settlement, and

    (e) both parties to the contract are expected to satisfy their respective obligations.

Combination and segmentation of contracts

17. In most cases, an entity applies the requirements of this model to a single contract with a customer. However, in some cases, the timing and amount of revenue recognition might vary depending on whether an entity combines or segments its contract(s).

18. An entity shall combine two or more contracts, and account for them as a single contract, if the prices of those contracts are interdependent. Conversely, an entity shall account for a single contract with a customer as two or more contracts if some goods or services in the contract are priced independently of other goods or services in the contract.

19. An entity shall use judgment and consider all relevant facts and circumstances when determining whether prices of contracts are interdependent. Typically, contracts with interdependent prices are contracts that:

    (a) are entered into at or near the same time,

    (b) are negotiated as a package with a single commercial objective, and

    (c) are performed either concurrently or continuously.

20. Goods or services in a contract are priced independently of other goods or services in the same contract only if:

    (a) the entity, or another entity, regularly sells the goods or services on a standalone basis, and

    (b) the price for all goods or services in the contract approximates the sum of the *standalone selling price* of each good or service (i.e. the customer does not receive a discount for buying a bundle of goods or services).

Contract modifications

21. A contract modification includes any change in the scope, price, or duration of the contract. A modification may be initiated by the customer or by the entity. Examples include changes in the design or quantity of the goods or services, and changes in the method or timing of performance.

22. An entity shall account for a contract modification only if the conditions in paragraph 16 are met.

23. An entity shall account for a contract modification as a separate contract if it is priced independently of the original contract. If the prices are interdependent, an entity shall account for the contract modification together with the original

contract, recognizing the cumulative effect of the modification in the period in which the modification occurs.

Recognition

Identifying performance obligations

24. **An entity shall evaluate all goods or services promised in the contract to determine whether to account for each promised good or service as a separate performance obligation. That evaluation shall be performed at contract inception and as each good or service in the contract is transferred to the customer.**

25. Entities often enter into contracts that oblige them to provide various goods or services to customers in exchange for consideration. Those goods or services include:

    (a) delivery of products,

    (b) rendering of services,

    (c) production or manufacturing of assets,

    (d) granting of licenses, options or other rights,

    (e) standing ready to provide a good or service.

26. Goods or services do not include amounts paid to the customer in the form of cash, credit, or other items that the customer can apply against amounts owed to the entity.

27. Paragraphs 78–96 provide additional guidance on identifying performance obligations.

28. If an entity transfers all the promised goods or services to a customer at the same time, it is not necessary to account for each performance obligation separately. The entity would have, in effect, a single performance obligation and would recognize all of the revenue when the customer obtains *control* of all the promised goods or services.

29. If an entity transfers the promised goods or services at different times (or continuously), the entity must determine whether to account for each performance obligation separately. An entity shall account for a performance obligation separately if the promised good or service is distinct from other goods or services promised in the contract.

30. A good or service is distinct if the entity, or another entity, sells an identical or similar good or service separately in the customer's market. The customer's market is the market in which the entity typically sells its goods or services.

31. If a good or service is not sold separately, an entity shall use judgment and consider all relevant facts and circumstances when determining whether the good or service is distinct and, hence, shall be accounted for as a separate performance obligation. Typically, a good or service is distinct from other goods or services in the contract if it:

    (a) is identified separately in the contract,

    (b) has a distinct profit margin (for instance, the resources required to provide the good or service are managed separately by the entity, or the entity can separately identify the costs of providing the good or service),

    (c) has a distinct function (for instance, although the good or service is not sold separately, it has utility on its own or with other available goods or services), and

    (d) it is transferred to the customer at a different time.

32. If a promised good or service is not distinct, an entity shall combine the performance obligation for that good or service with other performance obligations until the entity has two or more performance obligations for goods or services that are distinct.

Satisfaction of performance obligations

33. **An entity shall recognize revenue when it transfers a promised good or service to the customer. An entity transfers a promised good or service and,**

hence, satisfies a performance obligation when the customer obtains control of that good or service.

34. In some cases, a performance obligation is satisfied at a point in time because the entity transfers the good or service underlying that performance obligation discretely (e.g. a product). In other cases, a performance obligation is satisfied continuously because the entity transfers goods or services to the customer continuously (e.g. a product warranty). In all cases, the pattern of revenue recognition depicts the transfer of goods or services to the customer.

35. An entity shall evaluate the transfer of control for each separate performance obligation identified in paragraphs 24–32.

36. If a performance obligation is to produce, manufacture, or construct an asset, the entity must evaluate the transfer of control for the asset in its partially-completed state and not for the asset in its completed state.

37. An entity shall use judgment and consider all relevant facts and circumstances when determining whether a customer has obtained control of a good or service. Indicators that the customer has obtained control of a good or service include:

    (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 present 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 (e.g. cases in which a seller retains title as protection against the customer's failure to pay).

    (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, transfer of physical possession does not coincide with the transfer of control of a good. For example, in some bill and hold arrangements, the entity may have physical possession of a good that the customer controls. Conversely, in a consignment arrangement, an entity may have transferred physical possession of a good but retains control of it.

(d) the customer specifies the design or function of the good or service—A good or service with a customer-specific design or function might be of little value to the entity or to any other customer. For instance, an entity might not be able to sell a customer-specific good to another customer. Therefore, an entity likely would require that the customer obtain control of a customer-specific good (and pay for any work to date) as it is created. A customer's ability at the beginning of a contract to choose from a range of options specified by the entity typically would not be a customer-specific good or service. However, a customer's ability to change the design or function of the good or service throughout the contract typically would be a customer-specific good or service.

38. An entity shall consider the indicators of control in paragraph 37 in relation to the objective of determining whether the customer has obtained control of a promised good or service. None of the indicators are determinative on a standalone basis and some indicators may not be relevant to a particular contract (e.g. physical possession may not be relevant to a services contract).

39. In some cases, it may not be clear whether the customer has obtained control of a promised good or service until the entity has evidence of the customer's acceptance of the good or service in accordance with the contract.

Continuous transfer of goods or services

40. When goods or services are transferred continuously, an entity must practically determine when to recognize revenue.

41. An entity shall select one revenue recognition method for each separate performance obligation identified in accordance with paragraphs 24–32.

42. An entity shall select the method that best depicts the transfer of goods or services to the customer, and apply that method consistently throughout the contract and across other contracts with similar characteristics.

43. Acceptable methods of recognizing revenue to depict the continuous transfer of goods or services to the customer include:

    (a) output methods that recognize revenue on the basis of units produced, units delivered, contract milestones, or surveys of work performed.

    (b) input methods that recognize revenue on the basis of costs incurred, labour hours expended, or machine hours used. A drawback of input methods is that the relationship of the inputs to the transfer of the goods or services may not hold because of inefficiencies 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.

    (c) methods based on the passage of time.

44. For practical purposes, when the pattern of transfer of goods or services over a specified period of time is indeterminate, revenue can be recognized on a straight-line basis over that period.

Initial Measurement

45. **The amount of revenue an entity shall recognize when it satisfies a performance obligation is the amount of consideration the entity expects to receive from the customer in exchange for the transferred good or service. An entity shall determine that amount by allocating the transaction price to the performance obligations.**

Determining the transaction price

46. An entity shall evaluate the terms of a contract and consider all relevant facts and circumstances to determine the transaction price. In some contracts, the

transaction price is readily determinable because the customer pays a fixed amount when the entity transfers the promised goods or services.

47. In other contracts, the transaction price is subject to a variety of changing circumstances. An entity shall update the transaction price as circumstances change throughout the contract.

48. An entity shall consider the effects of the following when determining the transaction price and allocating it to performance obligations:

    (a) variable consideration,

    (b) collectibility,

    (c) time value of money, and

    (d) noncash consideration.

Variable consideration

49. The amount of consideration a customer pays often varies because of discounts, rebates, refunds, incentives, performance bonuses/penalties, contingencies, or other adjustments to the amount of consideration the customer pays the entity in exchange for goods or services.

50. If an entity pays an amount of consideration to the customer in the form of cash, credit, or other items that the customer can apply against amounts owed to the entity, the entity shall use judgment in determining whether those amounts are:

    (a) a reduction of the transaction price and revenue (i.e. the customer receives a discount on the entity's goods or services), or

    (b) a payment for distinct goods or services that the entity receives from the customer (i.e. the customer is also acting as a supplier to the entity), or

    (c) a combination of (a) and (b) in which case the entity reduces the transaction price by the amount of consideration paid to the customer in excess of the fair value of the goods or services the entity receives from the customer.

51. An entity shall include an estimated amount of variable consideration in the transaction price only if it can identify the possible outcomes of a contract (i.e. consideration amounts) and reasonably estimate the probabilities of those outcomes. Otherwise, the transaction price is limited to the amount of consideration that is not variable.

52. An entity can identify the possible outcomes of a contract and reasonably estimate the related probabilities only if it:

    (a) has experience with identical or similar types of contracts, and

    (b) does not expect circumstances surrounding those types of contracts to change significantly.

53. An entity shall refer to the experience of other entities if it has no experience of its own. Factors an entity shall consider when assessing whether circumstances are likely to change significantly include:

    (a) the susceptibility of the consideration amount to external factors (e.g. volatility in the market, judgment of third parties, risk of obsolescence of the promised good or service),

    (b) the amount of time until the uncertainty is expected to be resolved,

    (c) the extent of an entity's experience with similar types of contracts, and

    (d) the variability in the range of possible outcomes.

Collectibility

54. Collectibility refers to the customer's credit risk—i.e. the customers' ability to pay the promised consideration. An entity shall adjust the transaction price to reflect the customer's credit risk. Hence, when the entity satisfies a performance obligation, the entity shall recognize revenue in the amount of consideration the entity expects to collect—i.e. the probability weighted expected amount. Subsequent assessments of the customer's ability to pay shall be recognized separately from revenue.

Time value of money

55. An entity shall adjust the transaction price for the time value of money whenever that effect is material. The entity shall use the discount rate that would be reflected in a financing transaction between the entity and its customer that did not involve the provision of other goods or services. That rate would reflect both the time value of money and credit risk. The entity shall report the effect of financing separately from the revenue from other goods or services.

Noncash consideration

56. In some contracts, an entity receives consideration from the customer that is in a form other than cash (i.e. noncash consideration). An entity shall measure noncash consideration at the fair value of the consideration at the date it is received. If an entity cannot reliably estimate the fair value of noncash consideration, it shall measure the consideration indirectly by reference to the selling price of the goods or services transferred in exchange for the consideration.

Allocating the transaction price to performance obligations

57. An entity shall allocate the transaction price to all performance obligations relative to the standalone selling prices of the goods or services underlying those performance obligations (i.e. on a relative standalone selling price basis).

58. 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. If a standalone selling price is not directly observable, an entity shall estimate it.

59. Paragraph 97 provides additional guidance on estimating selling prices.

60. After contract inception, an entity shall allocate any changes in the transaction price to all performance obligations. Amounts allocated to satisfied performance obligations shall be recognized as revenue in the period during which the transaction price changes. An entity shall reallocate the transaction price after contract inception if it receives additional information about the selling prices at contract inception of the promised goods or services. However, an entity shall

not reallocate the transaction price to reflect changes in standalone selling prices after contract inception.

Subsequent Measurement

Onerous performance obligations

61. An entity shall recognise a separate liability and a corresponding contract loss for any expected loss on satisfying a remaining performance obligation in the contract. The entity shall measure the liability at the amount of the direct costs to satisfy the performance obligation less the transaction price allocated to that performance obligation. Direct costs are the costs that are directly attributable to the specific contract or that were incurred only because the entity entered into the contract.
62. At each subsequent financial statement date, an entity shall update the measurement of the liability for the onerous performance obligation.

Presentation

63. On the statement of financial position, an entity shall recognize either a *contract asset* or a *contract liability* depending on the relationship between the entity's and the customer's performance.
64. A contract asset or contract liability does not include unconditional rights to consideration from the customer. A right to consideration is unconditional when nothing other than the passage of time is required before payment of that consideration is due. An entity shall account for unconditional rights to consideration in accordance with ASC Topic 310 *Receivables*/IFRS 9 *Financial Instruments*.

Disclosure

65. **To enable users of financial statements to evaluate the timing and amount of revenue recognition in contracts with customers, an entity shall disclose qualitative and quantitative information to help users understand:**

    (a) **the characteristics of its contracts with customers** (paragraphs 67–73), and

    (b) **the significant judgments, and changes in judgments, in the application of this model to those contracts** (paragraph 74–76).

66. If the disclosures required by this model and other Standards do not meet the objective in paragraph 65, an entity shall disclose whatever additional information is necessary to meet that objective.

Characteristics of contracts with customers

67. To help users understand the characteristics of its contracts with customers, an entity shall disclose information about its performance obligations, rights to consideration, and onerous contracts.

Performance obligations

68. 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 provide including any significant options that the customer has to acquire additional goods or services, and any significant performance obligations to arrange for another party to provide goods or services (i.e. if the entity is acting as an agent),

    (b) performance obligations that are accounted for together with other performance obligations in accordance with paragraphs 24–32,

    (c) when the entity typically satisfies its performance obligations and recognizes revenue,

(d) the relationship between its performance obligations and the revenue amounts presented or disclosed in accordance with other Standards,

(e) cancellation, returns, refunds or other obligations that significantly affect the timing and amount of revenue recognition.

69. An entity shall disclose the amount allocated to remaining performance obligations. If an entity does not expect to satisfy its remaining performance obligations within the subsequent annual reporting period, an entity shall disclose the amount of the transaction price allocated to performance obligations expected to be satisfied:

(a) within one year,

(b) between two and five years, and

(c) greater than five years.

Rights to consideration

70. An entity shall disclose information about its contractual rights to consideration from the customer. That information includes a description of the payment terms and the extent of noncash consideration, variable consideration, and financing.

71. An entity also shall disclose:

(a) the amount of revenue recognized in the current period from noncash consideration,

(b) the amount of revenue recognized in excess of amounts to which the entity is legally entitled,

(c) the amount of interest income or interest expense arising from contracts with customers.

Onerous contracts and other risks

72. An entity shall disclose the amount of any additional liability recognized in accordance with paragraphs 61–62 of this model together with a discussion of:

(a) the nature and amount of the performance obligations for which the additional liability has been recognized,

(b) the reasons why those performance obligations have become onerous, and

(c) the time period over which the liability is expected to be utilized.

73. An entity shall also disclose information about the nature and extent of significant risks arising from contracts with customers and for which disclosure is not provided in accordance with other Standards.

Significant judgments in the application of this model

74. An entity shall disclose the significant judgments, and changes in judgments, in sufficient detail to communicate the effect of those judgments on the timing and amount of revenue recognition in contracts with customers including information to help users understand:

(a) the effect on the amount of revenue recognized in the current period (including how much relates to the satisfaction of performance obligations in previous periods); and

(b) an indication of the expected effect on the timing and amount of revenue recognition in future periods.

75. An entity shall disclose information about the methods and policies used to recognize revenue in a way that depicts the transfer of goods or services to customers including an explanation of why such methods are a suitable depiction of the transfer of goods or services.

76. An entity shall disclose information about the estimates, inputs and assumptions used to allocate consideration to performance obligations, including those used:

(a) to estimate the amount of any uncertain consideration and non-cash consideration included in the amount of revenue recognized,

(b) to estimate standalone selling prices,

(c) to estimate returns, warranties, refunds and other obligations, and

(d) to measure the amount of the additional liability related to onerous contracts.

Implementation guidance and illustrations

77. To implement the principles in the proposed model, an entity shall consider the following implementation guidance:

    (a) identifying performance obligations, and

    (b) estimating selling prices.

Identifying performance obligations

Principal versus agent considerations

78. 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 (i.e. the entity is a principal), or to arrange for another party to provide those goods or services (i.e. the entity is an agent). That determination affects whether the entity recognizes revenue in the gross amount collected from the customer or the net amount the entity retains after compensating other parties for their goods or services.

79. If an entity obtains control of the goods or services of another party in advance of transferring those goods or services to the customer, the entity's performance obligation is to provide the goods or services itself. Hence, the entity shall recognize revenue in the gross amount collected from the customer.

80. Indicators that the entity's performance obligation is to arrange for the provision of goods or services of another party (i.e. that the entity is an agent and should recognize revenue net) include:

    (a) the other party is primarily responsible for fulfilment of the contract,

    (b) the entity does not have inventory risk,

    (c) the entity does not have discretion in establishing prices,

    (d) the entity's consideration is in the form of a commission, and

(e) the entity does not have customer credit risk.

81. 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, the entity shall not recognize revenue for that performance obligation.

Options to acquire additional goods or services

82. Entities sometimes grant a customer the option to acquire additional goods or services. Those options come in many forms including, but not limited to, sales incentives, discounts on future goods or services, and contract renewal options.

83. If an entity grants a customer the option to acquire additional goods or services, that promise gives rise to a performance obligation only if the option provides a material right to the customer that the customer would not receive without entering into that contract. In those cases, the customer in effect has made a prepayment toward future goods or services and the entity recognizes revenue when the option expires or when those future goods or services are transferred.

84. When estimating a standalone selling price for a customer's option to acquire additional goods or services, that estimate shall reflect the discount the customer would obtain when exercising the option, adjusted for the following:

(a) the discount that the customer would receive without exercising the option, and

(b) the likelihood that the option will be exercised.

85. If a customer has the option to acquire goods or services that (a) are similar in nature to the original goods or services in the contract, and (b) are provided in accordance with the original terms of the contract, an entity may 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 (e.g. renewal and cancellation options).

Licenses and rights to use

86. Entities sometimes grant licenses in contracts with customers. In general, licensing refers to an entity granting a customer the right to use, but not own,

intellectual property of the entity. Licenses and rights to use come in many forms, including:

(a) software licenses,

(b) franchises, such as the right to operate a business using a franchise name or right-to-use a franchise process, and

(c) rights to music, film, or other media.

87. If a customer obtains control of the entire licensed intellectual property of the entity, the contract shall be considered a sale, rather than a license or lease, 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 the duration of its economic life.

88. If a customer does not obtain control of the entire licensed intellectual property and the entity has promised to grant an exclusive license, the entity has a performance obligation that it satisfies over time as it permits the customer to use its intellectual property.

89. In all other cases, the promised asset is the license. The promise to grant that license is a single performance obligation. The entity satisfies that obligation when it enables the customer to use the license and benefit from it. If there are other performance obligations in the contract, an entity shall determine whether the performance obligation for the license should be accounted for separately in accordance with paragraphs 24–32.

Rights of return

90. When an entity sells goods with a right of return, the entity shall not recognize revenue for the goods that are expected to be returned, but instead shall recognize a refund liability for the expected (probability weighted) amount of refunds to customers.

91. Subsequently, an entity shall update the refund liability for changes in expectations about the amount of refunds and make a corresponding adjustment to the amount allocated to the performance obligations.

92. An entity shall recognize an asset (and corresponding adjustment to cost of sales) for its right to recover goods from customers on settling the refund liability, initially measured at the original cost of the goods (that is, the former carrying amount in inventory).

93. The promised return service shall not be accounted for as a separate performance obligation in addition to the refund obligation.

Product warranties and product liabilities

94. If the objective of a product warranty is to provide a customer with coverage for latent defects (i.e. those that exist when the asset is transferred to the customer but which are not yet apparent), that warranty does not give rise to a separate performance obligation. Instead the warranty acknowledges the possibility that the entity has not satisfied its performance obligation to transfer the asset specified in the contract. Therefore, on the basis of all the available evidence, the entity shall determine at the end of the reporting period the likelihood and extent of defects in the assets it has sold to customers and, hence, the amount of unsatisfied performance obligations with respect to those assets. Consequently:

    (a) if the entity will be required to replace defective assets, it does not recognize revenue for those assets;

    (b) if the entity will be required to repair defective assets, it does not recognize the portion of revenue that can be attributed to components that need to be replaced in the repair process.

95. 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 separate performance obligation. Therefore, the entity allocates part of the transaction price to that warranty performance obligation.

96. If the law requires an entity to pay compensation if its products cause harm or damage, that requirement does not give rise to a performance obligation. The entity shall account for such obligations in accordance with IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* or FASB Accounting Standards Codification Subtopic 450-20, *Loss Contingencies*.

Estimating selling prices

97. When estimating standalone selling prices, an entity shall maximize the use of observable inputs and shall apply estimation methods consistently for goods or services with similar characteristics. Suitable estimation methods include (but are not limited to):

    (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.

    (b) adjusted market assessment approach—an entity could evaluate the market in which it regularly sells goods or services, and could 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.

Glossary

Contract—an agreement between two or more parties that creates enforceable rights and obligations.

Contract asset—the asset resulting from an entity transferring goods or services and recognizing revenue in advance of a customer paying consideration for that performance.

Contract liability—the liability resulting from a customer paying consideration in advance of an entity transferring goods or services and recognizing revenue.

Control (of a good or service)—an entity's present ability to direct the use of and receive the benefit from that good or service (or the present ability to prevent other entities from directing the use of and receiving the benefit from that good or service).

Customer—a party that has contracted with an entity to obtain goods or services that represent an output of the entity's ordinary activities.

Performance obligation—an enforceable promise in a contract with a customer to transfer a good or service to that customer.

Standalone selling price (of a good or service)—the price at which the entity would sell that good or service if it was sold separately to the customer at contract inception.

Transaction price—the probability-weighted estimate of the amount of consideration from the customer.