STAFF PAPER

31 October 2014

Project	**FASB/IASB Joint Transition Resource Group for Revenue Recognition**
Paper topic	Presentation of a contract as a contract asset or a contract liability

CONTACT(S)	Raghava Tirumala	rtirumala@ifrs.org	+44 207 246 6953
	Mary Mazzella	msmazzella@fasb.org	+1 203 956 3434

Background and purpose

1. IFRS 15 *Revenue from Contracts with Customers* and Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (collectively referred to as the 'new revenue standard') provide guidance on the presentation of a contract with a customer in the statement of financial position.

2. Some stakeholders have questions on the application of the guidance in the new revenue standard about the presentation of contract assets and contract liabilities. This paper summarises the potential implementation issues that stakeholders have reported to the staff.

3. Some of the questions arise because some stakeholders are uncertain about how to evaluate the contract asset and contract liabilities presentation concepts compared to existing guidance. Although *contract assets* and *contract liabilities* are new terms, the notion of assets and liabilities arising from a revenue arrangement exists in some areas of current accounting guidance. For example, under current accounting guidance, if an entity collects a fee before delivering a good or service, the amount is recognized as a liability (sometimes described as deferred revenue or payment in advance). Under this same scenario in the new revenue standard, an entity would recognize a contract liability. As another example, an entity with a long-term construction contract recognizes an asset to reflect revenue in excess of billings under current accounting guidance (sometimes described as gross

amounts due from customers on contracts or costs and accrued earnings in excess of billings on contracts). Under this same scenario in the new revenue standard, an entity would recognize a contract asset because it has transferred goods or services to the customer before the customer pays consideration or before payment is due.

Accounting guidance

4. Paragraphs 105-107 [606-10-45-1 through 45-3] state that:[1]

> 105 When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.
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> 106 If a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional (ie a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.
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> 107 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess

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[1] Paragraph references within '[XX]' are from the FASB *Accounting Standards Codification*.

a contract asset for impairment in accordance with IFRS 9 [Topic 310 on receivables]. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of IFRS 9 (see also paragraph 113(b)) [Topic 310 (see also paragraph 606-10-50-4b)].

5. The boards' rationale for the above guidance is as follows:

BC317 The boards decided that the remaining rights and performance obligations *in a contract* should be accounted for and *presented on a net basis*, as either a contract asset or a contract liability. The boards noted that the rights and obligations in a contract with a customer are interdependent—the right to receive consideration from a customer depends on the entity's performance and, similarly, the entity performs only as long as the customer continues to pay. The boards decided that those interdependencies are best reflected by *accounting and presenting* on a net basis the remaining rights and obligations in the statement of financial position. [Emphasis added.]

Potential implementation issues

Issue 1: How should an entity determine the presentation of a contract that contains multiple performance obligations?

6. Paragraphs 105 and 106 [606-10-45-1 and 45-2], together with the definitions of a contract asset[2] and contract liability[3], explain when an entity has a contract asset and a contract liability. Some stakeholders have questioned whether an entity could have a contract asset *and* a contract liability for a single contract when, for

[2] An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

[3] An entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.

instance, the entity has satisfied (or partially satisfied) one performance obligation in a contract for which consideration is not yet due, but has received a prepayment in respect of another unsatisfied performance obligation in the contract. Some stakeholders initially have the impression that the performance obligation, rather than the contract, is the level at which contract assets and contract liabilities are presented in the statement of financial position. Those stakeholders observe that under the new revenue standard, the amount and timing of revenue recognition is determined based on progress towards complete satisfaction of each performance obligation.

7. Other stakeholders note that paragraph 105 [606-10-45-1], together with the explanation in paragraph BC317, states that contract asset or contract liability positions are determined for each contract on a net basis. In other words, an entity nets each contract to *either* a contract asset or a contract liability and does not recognize separately a contract asset *and* a contract liability for a single contract.

8. In accordance with paragraph 105 [606-10-45-1], if the contract position incorporates an unconditional right to consideration (that is, only the passage of time is required before payment of that consideration is due), that amount is, in effect, extracted from the net contract position and presented separately as a receivable. Therefore, an entity might present a receivable *and* a contract asset or a receivable *and* a contract liability (as illustrated in Examples 39 and 40).

9. As noted in paragraph BC320, the entity would apply other presentation guidance to determine whether to present the sum of its contract assets and the sum of its contract liabilities as separate line items in the statement of financial position. An entity would be able to describe those items using alternative descriptions in accordance with paragraph 109 [606-10-45-5].

Issue 2: How should an entity determine the presentation of two or more contracts that have been combined under Step 1 (identify the contract with the customer) in accordance with paragraph 17 [606-10-25-9]?

10. When two or more contracts are entered into at or near the same time with the same customer (or related parties of the customer) and combined in accordance with paragraph 17 [606-10-25-9], an entity accounts for those individual contracts as if they were a single contract. Some stakeholders think that the presentation

guidance is unclear about whether the contract asset or contract liability position should be determined for (a) the combined contracts as if they were a single contract or (b) each contract separately. This issue would relate to any scenario in which contracts are combined; however, for some, this issue is more pertinent when the contracts that are combined include contracts with related parties of the customer (that is, the combined contracts are not with the same counterparty). Below are some considerations about how stakeholders note that the guidance is applied.

11. One view is that the contract asset or contract liability position is determined for the combined contracts because the guidance states that they are accounted for as if they were one single contract. Paragraph 17 [606-10-25-9] states that:

> An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a *single contract* if one or more of the following criteria are met …
>
> [Emphasis added.]

12. BC72 further suggests that the objective of combining contacts is to “identify[ing] the contract that is to be accounted for as the unit of account.” In other words, the rights and obligations in the individual contracts are interdependent across the combined contracts and this is best reflected by combining the individual contracts as if they were a single contract. In paragraph BC317, it is acknowledged that the interdependencies of the rights and obligations in a contract are best reflected by accounting *and presenting* on a net basis the remaining rights and obligations in the statement of financial position. Some think this is the case regardless of whether the rights and obligations arise from a single contact, contracts with the same customer that have been combined, or contracts with the customer and related parties of the customer that have been combined.

13. Another view is that the contract asset or contract liability position is determined for each of the individual contracts in the combined contract separately. However, under this view, to reflect the amounts due from or to the individual counterparty (or related counterparties), an entity might need to adjust the

amounts that would otherwise be recognised as contract assets and contract liabilities arising from satisfying the individual performance obligations in the combined contract. This is because the transaction price would be allocated across the performance obligations in the combined contract.

Issue 3: When can an entity offset other balance sheet items against the contract asset or liability?

14. The first two issues in this paper discuss the presentation of contract assets and contract liabilities arising from individual contracts with customers and contracts that have been combined. However, in addition to requiring the recognition of contract assets and contract liabilities, other assets and liabilities arise when accounting for transactions under the new revenue standard. Accordingly, stakeholders have raised questions about whether these other assets and liabilities may be offset against the contract assets and contract liabilities. In addition, questions have been raised about whether a contract asset or liability arising from one contract could be offset against a contract asset or liability arising from another contract.

15. For example, assume that in a single contract, the entity has invoiced the customer and recognised a receivable for that invoiced amount (because it represents an unconditional right to consideration). Also assume that the entity has collected on previous billed receivables in advance of performance. Therefore the entity has recognised a receivable for the current amount billed and a contract liability for the prior amounts collected. Stakeholder question if there are any circumstances in which the receivable and contract liability could be offset against each other.

16. The new revenue standard does not provide guidance about offsetting of balances, other than the guidance discussed under Issues 1 and 2 in this paper. Current presentation guidance exists in IFRS and GAAP apart from the new revenue standard. Most stakeholders think that an entity would apply that other presentation guidance, for example the offsetting principles in other IFRSs (such as IAS 1 *Presentation of Financial Statements,* IAS 32 *Financial Instruments: Presentation*) and GAAP (such as FASB *Accounting Standards Codification* Subtopic 210-20 – Balance Sheet Offsetting) to determine the appropriate netting.

Questions for TRG members
1. What are your views about the potential implementation issues included in this paper?
2. Are you aware of other interpretations for the issues that are not included in this paper?