IFRS® Accounting

Educational Module 23
Revenue from Contracts with Customers

IFRS for SMEs®
Accounting Standard
Third Edition

International Accounting Standards Board

IFRS® Foundation
Supporting Material for the
IFRS for SMEs® Accounting Standard

including the full text of
Section 23 *Revenue from Contracts with Customers*
of the *IFRS for SMEs* Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 23 *Revenue from Contracts with Customers* of the *IFRS for SMEs* Accounting Standard are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs* Accounting Standard contains the glossary (Glossary) and is part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 23.

This module has been prepared by International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs* Accounting Standard and have not been approved by the IASB.

INTRODUCTION

IFRS for SMEs® Accounting Standard

The *IFRS for SMEs* Accounting Standard (Standard) is intended for use by small and medium-sized entities that publish general purpose financial statements and that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The objective of general purpose financial statements is to provide information about an entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

This module

This educational module supports the requirements for accounting and reporting of revenue in accordance with Section 23 *Revenue from Contracts with Customers*.

The module:

- provides explanations and examples to improve understanding of the requirements in Section 23;
- identifies the significant judgements required to account for revenue from contracts with customers;
- includes questions to test your understanding of the requirements in Section 23; and
- includes case studies that provide a practical opportunity to apply the Section 23 requirements.

After completing the module, you should be able:

- to identify contracts with customers that are within scope of Section 23;
- to explain the revenue recognition model for accounting for contracts with customers and demonstrate how to apply the model;
- to demonstrate how to account for costs to obtain contracts with customers;
- to identify costs to fulfil contracts with customers that are recognised as assets and how to measure such assets;
- to present information that would satisfy the requirements for contract balances in Section 23;
- to disclose information that would satisfy the disclosure requirements in Section 23; and
- to demonstrate an understanding of some of the significant judgements that are required to account for revenue from contracts with customers.

Which version of the Standard does the module refer to?

Any reference in this module to 'the *IFRS for SMEs* Accounting Standard' is to the third edition of the Standard, issued February 2025.

Introduction to the requirements

Revenue from contracts with customers is the amount receivable by an entity in exchange for transferring goods or services to its customers. Understanding revenue helps users of financial statements analyse an entity's performance and its ability to generate cash flows in the future.

Section 23 requires an entity to recognise an amount of revenue that depicts the goods or services that the entity has transferred to customers and that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. The section describes the revenue recognition model an entity applies to account for revenue in this way. The model has five steps:

- **Step 1: Identify the contract(s) with a customer**—a contract is an agreement between two or more parties that creates enforceable rights and obligations.
- **Step 2: Identify the promises in the contract**—a contract includes obligations to transfer goods or services to a customer. If those goods or services are distinct, the obligations are identified as 'promises' and accounted for separately.
- **Step 3: Determine the transaction price**—the transaction price is the amount of consideration in a contract an entity expects to be entitled to in exchange for transferring goods or services promised to a customer.
- **Step 4: Allocate the transaction price to the promises in the contract**—an entity typically allocates the transaction price to each promise based on the relative stand-alone selling price of the distinct good or service in each promise in the contract.
- **Step 5: Recognise revenue when (or as) the entity fulfils a promise**—an entity recognises revenue when (or as) the entity fulfils a promise by transferring control of the good or service in the promise to the customer.

Alongside the revenue recognition model, Section 23 provides application guidance on how to account for features found in more complex contracts with customers. The section also covers how to account for costs associated with contracts with customers.

What has changed in the third edition of the Standard?

In the second edition of the Standard, Section 23 was based on IAS 11 *Construction Contracts* and IAS 18 *Revenue*. In the third edition of the Standard, the IASB revised Section 23 to be based on IFRS 15 *Revenue from Contracts with Customers*, which was issued in 2014 and replaced IAS 11 and IAS 18.

REQUIREMENTS AND EXAMPLES

Scope of this section

23.1 This section applies to all **contracts** with **customers**, except:

(a) **lease** contracts within the scope of Section 20 *Leases*;

(b) **insurance contracts**;

(c) **financial instruments** and other contractual rights or obligations within the scope of Section 9 *Consolidated and Separate Financial Statements*, Section 11 *Financial Instruments*, Section 14 *Investments in Associates* or Section 15 *Joint Arrangements*; and

(d) non-cash exchanges of products between entities in the same line of business to help make sales to customers.

Educational notes

Income and revenue excluded from scope

In addition to paragraph 23.1, the scope of Section 23 is indicated by its title: *Revenue from Contracts with Customers*. The terms 'revenue' and 'customers' are defined in the Glossary:

revenue Income arising in the course of an entity's ordinary activities.

customers A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

A transaction might generate income that is not revenue because it does not arise in the course of an entity's ordinary activities. For example, the sale of an item of property, plant and equipment might generate income that is not an output of an entity's ordinary activities. The nature of this income means it is not revenue and not within the scope of Section 23. Consequently, the income is accounted for in accordance with Section 17 *Property, Plant and Equipment*.

A transaction might generate income that is revenue but that is not in scope of Section 23 because it does not arise from a contract with a customer. For example, investment income may arise from an investor's ordinary activities. However, the investor does not receive this income in exchange for transferring goods or services to the investee. Therefore, because the investee is not a customer the income is not within the scope of Section 23.

Example—Revenue and income

Ex 1 **An SME runs a chain of bicycle shops that hold bicycles for rental and for sale. The bicycles available for rent are donated to local charities after two to three years.**

At the start of 20X1, the SME sold a property that it previously operated as a shop. The SME invested the sale proceeds into a fixed-rate bond. At the end of 20X1, the SME sold the bond and purchased a larger property out of which it traded.

The SME recognises revenue from both bicycle sales and rentals. Revenue from bicycle sales is recognised in accordance with Section 23. Revenue from bicycle rentals is recognised in accordance with Section 20.

Because the SME's investment in the bond is a financial instrument, the interest from the bond is accounted for in accordance with Section 11.

Because the SME's ordinary activities are renting and selling bicycles, not selling property, the proceeds from selling the property are not recognised as revenue and are instead accounted for in accordance with Section 17.

Donations of second-hand bicycles are disposals of property, plant and equipment.

Example—Non-cash exchanges

Ex 2 **To fulfil an urgent order from a customer, fuel retailer X received CU180,000 of diesel from fuel retailer Y in exchange for CU180,000 of petrol.**[1]

Fuel retailer X does not recognise revenue arising from the exchange of petrol for diesel with fuel retailer Y because the exchange was an exchange of products to help make sales to customers.

The exchange with fuel retailer Y was similar to a transaction to purchase inventory from a supplier and is therefore accounted for in accordance with Section 13 *Inventories*.

1 In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units' (CU).

23.2 A contract with a customer might be partially within the scope of this section and partially within the scope of other sections listed in paragraph 23.1. If one of the other sections specifies how to initially measure any parts of the contract, then an entity shall first apply the measurement requirements in that section. Otherwise, the entity shall apply this section to initially measure those parts of the contract.

Educational notes

Paragraph 23.2 describes the order in which an entity applies the requirements in Section 23 and another section of the Standard if it is accounting for a contract that is partially in the scope of both sections.

Example—Lease with a non-lease component

Ex 3 An SME rents out properties. Tenants are given the option to use the SME's weekly cleaning service. The charge for the cleaning service is included as part of the tenant's monthly lease payment.

Contracts in which a tenant chooses to use the SME's weekly cleaning service contain a lease and non-lease component (cleaning service). These contracts are partially within the scope of Sections 20 and 23.

Section 20 requires a lessor to exclude income for services from payments received from lessees when accounting for lease income (see paragraphs 20.19 and 20.25). However, Section 20 does not specify how to initially measure the lease and non-lease component. Therefore, an SME would apply Section 23 to initially measure those components. This would require the SME to apply Steps 3 and 4 of Section 23. Because the allocation requirements in Step 4 are based on the promises identified in the contract, the SME would also apply Step 2 to identify the lease and non-lease components.

Revenue recognition model

23.3 This section describes the **revenue** recognition model an entity shall apply to account for revenue from contracts with customers. Applying the model requires an entity to recognise an amount of revenue that depicts the goods or services the entity has transferred to customers and that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. An entity shall apply the model in five steps:

(a) Step 1—Identify the contract(s) with a customer (see paragraphs 23.6–23.13);

(b) Step 2—Identify the **promises** in the contract (see paragraphs 23.14–23.22);

(c) Step 3—Determine the **transaction price** (see paragraphs 23.23–23.38);

(d) Step 4—Allocate the transaction price to the promises in the contract (see paragraphs 23.39–23.48); and

(e) Step 5—Recognise revenue when (or as) the entity fulfils a promise (see paragraphs 23.49–23.67).

Educational notes

The revenue recognition model contains five steps that determine when and how much revenue an entity recognises.

Order of the steps

An entity typically applies the five steps in sequence. However, in some instances, an entity might apply requirements out of sequence. For example, an entity might apply requirements in Step 5 to determine whether to account for a series of distinct goods or services as a single promise when applying paragraph 23.15 in Step 2.

Applicability and relevance of the steps

All five steps are applicable to all contracts in the scope of Section 23, other than Step 4 in the circumstances specified in paragraphs 23.40–23.41. However, for contracts in which it is relatively straightforward to determine the amount and timing of revenue recognition, it might not be necessary for an entity to go through the detailed requirements in each step.

For contracts in the scope of Section 23 that begin and end in the same reporting period, the model is relevant only for the purpose of making the disclosures required by the section. However, to decide when a contract ends, an entity would need to apply Steps 2 and 5 to identify the promises in the contract and determine when those promises are fulfilled.

23.4 An entity shall apply this section consistently to contracts with similar characteristics and in similar circumstances.

Educational notes

Entities typically transfer goods or services to customers by entering into contracts with similar characteristics and in similar circumstances. For these contracts, an entity is required to apply the revenue recognition model in the same way.

Applying the revenue recognition model in the same way for similar contracts in all reporting periods means the information about an entity's revenue can be compared with information about the entity's revenue for other periods, making the information more useful to users of financial statements.

Example—Applying Section 23 consistently

Ex 4 **An SME provides garden maintenance services. The SME's contracts have terms that are the same for all customers. Services are provided as needed for 12 months, with a maximum of three visits per month. The SME has a right to invoice the customer for time spent providing garden maintenance services. Customers pay an hourly rate of CU50 for services provided.**

For all its contracts, the SME has a right to consideration from its customers in an amount that relates directly to the value of its work completed to date. In accordance with paragraph 23.67, the SME is eligible to recognise revenue equal to the amount of consideration that it has a right to invoice.

Because the SME's contracts have similar characteristics, if it chooses to recognise revenue at an amount equal to the amount of consideration that it has a right to invoice, it is required to do so for all its contracts. Recognising revenue in this way for all contracts means the SME applies paragraph 23.67 consistently to contracts with similar characteristics.

23.5 This section specifies how an entity accounts for an individual contract with a customer. An entity is permitted to apply this section to a portfolio of similar contracts (or promises) if the entity reasonably expects that the result of doing so would not differ **materially** from the result of applying the section to each individual contract (or promise).

Educational notes

A contract or promise is the unit of account for the purpose of recognising revenue, and most requirements in the section apply to individual contracts or promises in a contract. However, an entity can apply requirements to a portfolio of similar contracts or promises instead of on an individual basis.

An entity groups contracts or promises into a portfolio based on the expected results of accounting for the contracts or promises collectively instead of individually. To group contracts or promises into a portfolio, the entity needs to reasonably expect that the results of accounting for the contracts or promises collectively would not differ materially from the result of accounting for each contract or promise individually. This conclusion is based on what the entity reasonably expects—the entity is not required to quantify the difference between the two methods of accounting for the contracts or promises individually and accounting for them as a portfolio.

Examples—Portfolio approach

Ex 5 **An SME sells machinery. One of the models of machinery is sold with training on how it operates. In a contract with a customer to sell the machinery and training, the machinery and training are distinct. The SME estimates the training's stand-alone selling price based on its expected costs plus a margin of 40%.**

The costs of the training are determined by its duration, which is about three hours. However, this can vary depending on factors specific to each customer (for example, how many people attend the training and their familiarity with the machinery).

For all contracts entered into during the reporting period to transfer the machinery and deliver training, the SME estimates the training's stand-alone selling price based on an expected duration of three hours.

The SME determines the training's stand-alone selling price for such contracts as a portfolio because it reasonably expects the result of determining that price for each contract individually would not be materially different from the result of determining it for the portfolio of contracts.

Ex 6 **An SME has a large volume of similar contracts with customers. For some contracts, payment is deferred beyond normal business terms.**

Although payment for some contracts is deferred beyond normal business terms and the arrangement constitutes a financing transaction, the SME expects most customers will pay within one year of the goods or services being transferred.

The SME applies the option in paragraph 23.38 to all contracts as a portfolio, so it does not account for interest revenue separately from revenue from contracts with customers.

Although the SME expects that a few contracts will not meet the condition to apply the option, it still applies the option to these contracts. This is because the SME reasonably expects the result of applying the option to each contract individually would not be materially different from the result of applying it to the portfolio of contracts.

Step 1—Identify the contract(s) with a customer

Educational notes

The requirements in Step 1 of the revenue recognition model identify the contracts to which the model applies. The model applies only to contracts that meet specified criteria. In some cases, Section 23 requires an entity to combine contracts and account for them as a single contract.

23.6 A contract is an agreement between two or more parties that creates enforceable rights and obligations. Contracts can be written, oral or implied by an entity's usual business practices.

Educational notes

The rights and obligations created by a contract with a customer are set out in Figures 1 and 2.

Figure 1—A reporting entity's rights and obligations in a contract

A reporting entity has	a right	to receive	consideration
	an obligation	to transfer	goods or services

Figure 2—A customer's rights and obligations in a contract

A customer has	a right	to receive	good or services
	an obligation	to transfer	consideration

The enforceability of the rights and obligations in a contract is a matter of law that varies by jurisdiction and industry.

The agreement between the entity and customer does not need to be in writing to be a contract. Agreed-upon terms can be written, oral or evidenced otherwise.

Agreements that do not create enforceable rights and obligations and do not meet the definition of a contract will not usually meet all the criteria in paragraph 23.7.

Example—Contract not in writing

Ex 7 **An SME provides courier services, transporting items for customers at short notice. Customers request these services by telephone. Documentation is typically issued after the service has been performed.**

In the jurisdiction in which the SME operates, oral agreements create enforceable rights and obligations.

Once the services are agreed, an oral contract exists between the SME and its customer.

23.7 An entity shall apply the revenue recognition model to account for a contract with a customer that is within the scope of this section only when all of the following criteria are met:

(a) the parties to the contract have approved the contract and are committed to fulfilling their respective obligations;

(b) the entity can identify each party's rights in relation to the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance; and

(e) it is **probable** that the entity will collect the consideration that it is entitled to when the consideration is due.

23.8 If a contract with a customer meets the criteria in paragraph 23.7 at the start of the contract, an entity shall reassess whether the contract meets the criteria only if there is a significant change in relevant facts and circumstances.

Educational notes

Most contracts with customers would be expected to meet the criteria in paragraph 23.7.

The parties to the contract have approved the contract and are committed to fulfilling their respective obligations (paragraph 23.7(a))

An entity's and a customer's respective obligations in a contract are set out in Figures 1 and 2.

The entity can identify each party's rights in relation to the goods or services to be transferred (paragraph 23.7(b))

An entity's and a customer's respective rights in a contract are set out in Figures 1 and 2. The rights will be specific to the nature of the goods or services to be transferred. If an entity is unable to identify such rights, then it will be unable to identify the promises in the contract, as required by Step 2.

The entity can identify the payment terms for the goods or services to be transferred (paragraph 23.7(c))

If an entity is unable to identify the payment terms, then it will be unable to determine the transaction price, as required by Step 3.

The contract has commercial substance (paragraph 23.7(d))

An exchange has commercial substance if it has economic consequences for the entity (that is, the risk, timing or amount of the entity's future cash flows are expected to change). A contract can have commercial substance even if it is expected to incur a loss—for example, an onerous contract. Provisions related to onerous contracts are in the scope of Section 21 *Provisions and Contingencies* (see paragraph 21.1(b)).

It is probable that the entity will collect the consideration that it is entitled to when the consideration is due (paragraph 23.7(e))

This criterion establishes a collectability threshold for contracts. The Glossary defines probable as 'more likely than not'.

The amount of consideration the entity is entitled to is usually the price stated in the contract. However, the amount might be less than this price if the entity expects to offer a price concession. If an entity expects to provide a price concession, the consideration is variable. In such instances, an entity may consider the requirements for variable consideration in Step 3 to determine the amount of consideration to which it expects to be entitled.

The criteria in paragraph 23.7 are revisited only if there is a significant change in relevant facts and circumstances that could mean they are not met. For example, if a customer's ability to pay consideration deteriorates significantly, the entity would reassess whether it is probable that it will collect the consideration that it will be entitled to when the consideration is due.

Example—Assessing criteria for identifying a contract

Ex 8 The facts are the same as in Example 7.

At the point at which the services are agreed, an oral contract exists between the SME and its customers. At the start of the contracts, the SME typically assesses that the contracts meet the criteria set out in paragraph 23.7, because:

- contracts are approved with customers orally. The SME is committed to fulfilling its obligation to transport the item, and customers are committed to fulfilling their obligations to pay for this service (paragraph 23.7(a)).
- the SME can identify the service to be performed (to transport an item by a specific date) and its rights and customers' rights in relation to this service (paragraph 23.7(b)).
- the price for the service is based on a set day rate the SME quotes when agreeing the service. The SME's customary business practice is to invoice customers after the service is performed on normal credit terms (paragraph 23.7(c)).
- the SME's cash flows are expected to change because it will perform a service and receive cash from customers (paragraph 23.7(d)).
- based on past experience with customers that is expected to continue, the SME concludes that it is more likely than not that it will collect the consideration from customers after the service is performed (paragraph 23.7(e)).

23.9 If a contract with a customer does not meet the criteria in paragraph 23.7, an entity shall reassess the contract until the criteria are met.

23.10 When a contract with a customer does not meet the criteria in paragraph 23.7, an entity shall recognise any consideration received from the customer as a **liability**. If the consideration is non-refundable, the entity shall derecognise the liability and recognise the consideration as revenue when either:

(a) the contract is complete and the entity has received all, or almost all, of the consideration promised by the customer; or

(b) the contract is cancelled.

Educational notes

Contracts with customers that do not meet the criteria in paragraph 23.7 are reassessed until there is a change in relevant facts and circumstances and the criteria are met. For example, a contract that does not meet the criterion in paragraph 23.7(e) might meet the criterion if the customer's prospects for future cash flows improve because it has secured finance.

An entity might receive consideration from a customer while the criteria are not met. If the consideration is non-refundable, entities are prevented from recognising the consideration as revenue until the contract is complete or cancelled. These recognition requirements apply to:

- contracts that have never met the criteria; and
- contracts that have previously met the criteria but that no longer do.

Example—Consideration received before criteria for identifying a contract are met

Ex 9 **An SME enters into a contract to manufacture a specialised item of machinery for a customer for delivery by the end of the year. To meet this deadline, the SME begins manufacturing the machinery before the contract is approved.**

The SME receives an advance payment from the customer at the start of the contract of CU7,000 to help fund initial production costs. The payment represents 50% of the total price of the machinery and is non-refundable.

At the start of the contract, the SME assesses the contract as not yet meeting the criteria in paragraph 23.7 because it is not approved.

The SME recognises the CU7,000 received as a liability. The SME continues to account for any consideration received as a liability until such time that it concludes that the criteria are met, or one of the events in paragraph 23.10 occurs.

23.11 Some contracts with customers might have no fixed duration or might automatically renew periodically. An entity shall apply this section to the duration of the contract in which the parties to the contract have present enforceable rights and obligations.

Educational notes

The duration of a contract (that is, 'the contractual period') can affect the timing of revenue recognition.

For the purpose of applying Section 23, the contractual period is the period in which the parties to the contract have present enforceable rights and obligations.

Section 23 specifies two types of contract in which the contractual period might be unclear:

- *contracts that have no fixed duration*—the entity would need to study the terms of the contract or the entity's customary business practice to determine the contractual period. The entity would need to evaluate any termination clauses and penalties to determine whether these limit or extend the parties' rights and obligations.
- *contracts that automatically renew periodically*—parties to these contracts can often opt out of renewing at the end of each renewal period. Because an entity would not know if enforceable rights and obligations exist until the contract has been renewed, the contractual period cannot include anticipated renewals.

Example—Determining the duration of a contract that includes renewal options

Ex 10 An SME enters into a contract with a customer to supply services for one year. The contract includes an option to renew for a further year at the end of each year. Based on the SME's experience with similar contracts, it expects the customer to renew the contract for a further two years.

At the start of the contract, the duration of the contract is one year. The duration does not include anticipated renewal periods because, at the start of the contract, the SME and the customer do not have any present rights or obligations during these periods.

23.12 If a contract is modified, an entity shall account for the contract modification by applying paragraphs 23A.2–23A.4.

Educational notes

The Appendix to Section 23 includes requirements for contract modifications.

Combination of contracts

23.13 An entity shall combine two or more contracts it has 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:

(a) the contracts are negotiated as a package with a single commercial objective;

(b) the amount of consideration the customer will pay in one of the contracts depends on the price or performance of the other contract; or

(c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single promise in accordance with Step 2.

Educational notes

The requirements for combining contracts can change the contract to which an entity applies the revenue recognition model.

Contracts an entity combines are usually contracts that it has entered into with the same customer. However, an entity might also combine contracts entered into with a customer and a related party of that customer. An entity can refer to the definition of a 'related party' in the Glossary to decide whether two entities are related parties. However, the definition of a related party is written from the perspective of the reporting entity, not the customer. Consequently, for the purpose of applying paragraph 23.13, references to the reporting entity in the definition are read as reference to the customer.

Criteria for combining contracts

The criteria in paragraph 23.13(a)–(b) are related to the interdependence between contracts. Therefore, contracts that meet the criterion in paragraph 23.13(a) might also meet the criterion in paragraph 23.13(b).

The criterion in paragraph 23.13(c) means an entity is required to account for goods or services as a single promise if they are part of the same promise, even if the goods or service are part of different contracts.

Example—Combining contracts

Ex 11 **An SME enters into a contract with a customer to sell an item of machinery. At the same time, the SME enters into a contract with the same customer to deliver training on how to operate the machinery.**

The price for the machinery means the first contract is loss-making. However, the price for the training might mean the overall arrangement is profitable.

The contracts were negotiated with a single commercial objective: to sell machinery and training at a profit. Entering into one loss-making contract because the loss can be compensated for by another transaction is part of the SME's business model. Therefore, the criterion in paragraph 23.13(a) is met and the contracts are combined.

The criterion in paragraph 23.13(b) is also met because the price of the training was set to compensate for the loss on the sale of the machinery. Therefore, the price the customer pays for the training is dependent on the price of the other contract.

Step 2—Identify the promises in the contract

Educational notes

The requirements in Step 2 of the revenue recognition model identify the goods or services in a contract that are distinct and accounted for separately. As a result, the contract identified in Step 1 is split into separate components, known as 'promises'. This unit of account is used in Steps 4 and 5 of the model.

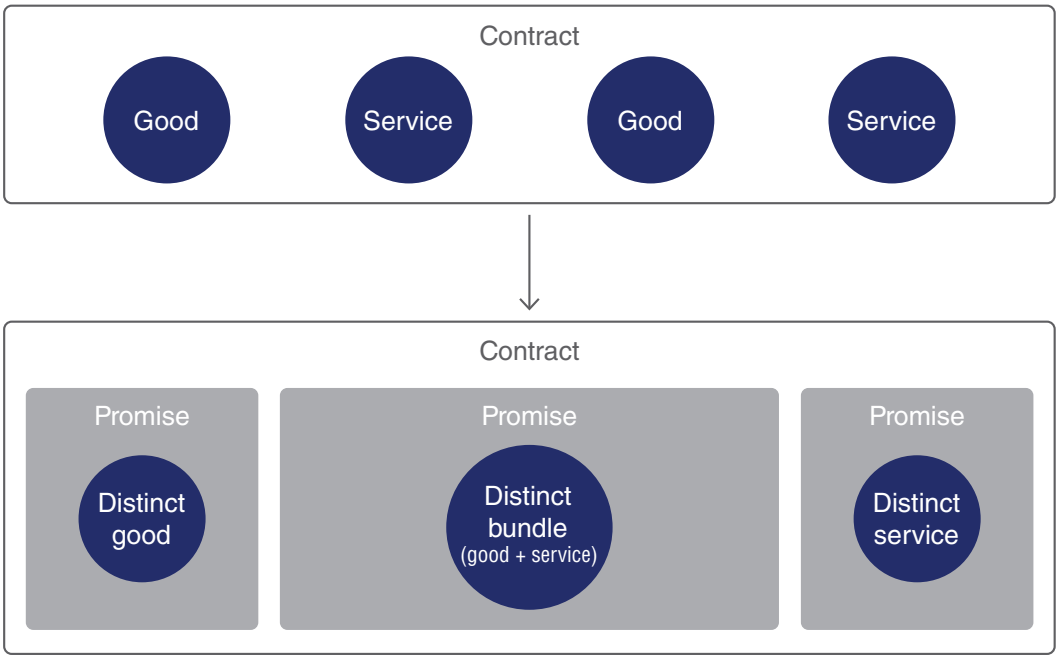
23.14 A promise is an obligation to transfer a distinct good or service (or a distinct bundle of goods or services). A contract with a customer might contain more than one promise. At the start of a contract, an entity shall identify the goods and services promised in the contract and determine which goods or services are distinct.

Educational notes

An entity identifies the promises in a contract by:

- identifying the goods or services that an entity has promised to transfer to the customer; and
- identifying which goods or services (or bundles of goods or services) are 'distinct'.

Figure 3—Identifying promises in a contract



In a simple contract, an entity might only promise to transfer one good or service, in which case applying Step 2 would be straightforward. However, in other contracts an entity might promise to transfer two or more goods or services, despite only one price being specified in the contract. In such cases an entity would need to identify which goods or services are 'distinct'. A good or service is distinct if the criteria in paragraph 23.18 are met.

A good or service might be distinct on its own or combined with other goods or services in the contract. In such instances, the combined goods or services form a bundle that is distinct.

The goods or services that an entity has promised to transfer to a customer might include:

- sale of goods produced by the entity (for example, a manufacturer's inventory);
- resale of goods purchased by the entity (for example, a retailer's merchandise);
- performing a contractually agreed-upon task (or tasks) for the customer;
- standing ready to provide goods or services (for example, unspecified updates to software that are provided on a when-and-if-available basis) or making goods or services available for the customer to use as and when the customer decides; or
- constructing, manufacturing or developing an asset on behalf of the customer.

23.15 An entity might transfer distinct goods or services to a customer that are essentially the same, but at discrete instances over time (that is, transfer a series of distinct goods or services). The entity shall account for those goods or services as a single promise if:

(a) each distinct good or service in the series would meet the criteria to be a promise fulfilled over time (see paragraph 23.54); and

(b) the entity would use the same method to measure its progress in transferring control of each distinct good or service in the series to the customer (see paragraphs 23.62–23.67).

Educational notes

Exception created by the 'series provision'

The 'series provision' in paragraph 23.15 is an exception to the definition of a promise in paragraph 23.14.

The definition of a promise results in a good or service being accounted for separately as a promise if the good or service is distinct. However, the series provision requires goods or services to be accounted for as a single promise in specific instances, even though the underlying goods or services are distinct.

The series provision aims to make an entity's accounting easier because it is not required to individually account for each distinct good or service within the series, only for a single promise. For example, an entity would account for a contract for a repeated service, such as a weekly cleaning contract, as a single promise instead of accounting for each cleaning visit as a separate promise.

Applying the series provision

To apply the series provision, the goods and services are required:

- to be distinct from each other (see paragraphs 23.18–23.22);
- to be essentially the same; and
- to meet the two criteria in paragraph 23.15 that relate to Step 5 of the revenue recognition model.

An entity might enter into an arrangement to provide an unspecified quantity of activities, instead of a defined number of services. In such instances, the nature of the service is the act of standing ready to provide the activities. Therefore, paragraph 23.15 is applied to the service of standing ready to provide the activities each day instead of the underlying activities.

For example, an entity could enter into a contract to repair a customer's vehicles for one year. In this contract, the entity will perform an unspecified amount of repair work. Therefore, the nature of the service is the act of standing ready to provide repair work and the requirements in paragraph 23.15 apply to the service of standing ready. In contrast, an entity could enter into a contract to provide 20 hours of repair services per month for one year. In this contract, the entity will perform a specified amount of repair work. Therefore, the nature of the service is the repair work and the requirements in paragraph 23.15 apply to the repair work.

Example—Series of distinct goods or services, specified quantity

Ex 12 An SME enters into a contract with a customer to produce 1,000 units of the same product each month for two years. The units are controlled by the customer as they are manufactured.

The good that the SME transfers to the customer is each unit produced. The units are the same as each other and each unit is distinct.

The SME accounts for the contract as a single promise because the contract is a series of distinct goods that are essentially the same, and:

- each good meets the criterion in paragraph 23.54(b) to be a promise fulfilled over time; and
- the entity would use the same method to measure its progress in transferring control of each good (a cost-based measure of progress).

Example—Series of distinct goods or services, unspecified quantity

Ex 13 An SME enters into a contract with a customer to run an IT help-desk five days a week for one year.

The service that the SME transfers to the customer is the act of standing ready to provide IT support. Each day of service is distinct. Even though the SME's activities in providing the service varies from day to day, the nature of the overall service remains the same.

The SME accounts for the contract as a single promise because the contract is a series of distinct services that are essentially the same, and:

- each service meets the criterion in paragraph 23.54(a) to be a promise fulfilled over time; and
- the entity would use the same method to measure its progress in transferring control of each service (a time-based measure of progress).

23.16 A contract with a customer usually explicitly states the goods or services that an entity promises to transfer. However, promises might be implied by an entity's usual business practices, published policies or specific statements, if these create a valid expectation of the customer that the entity will transfer a good or service to the customer.

Educational notes

Goods or services to be transferred might not be formally documented in a contract between an entity and a customer. Instead, the goods or services might be implied by the entity's usual business practices. When such practices create a valid expectation of the customer that the entity will transfer a good or service, the entity is required to consider the good or service when identifying the promises in the contract. This means that goods and services that are part of the negotiated exchange between an entity and its customer will be considered as part of Step 2 of the revenue recognition model. This will be the case even if the goods or services are not specified in the contract.

Example—Goods or services not explicitly stated in contract

Ex 14 An SME sells machinery to a customer. The SME has historically provided maintenance services to customers that buy machinery from the SME for no additional consideration (that is, for free). The SME does not explicitly agree to provide maintenance services during negotiations with the customer and the final contract between the SME and the customer does not specify terms and conditions for maintenance services.

The SME determines that its past practice of providing maintenance services to customers that buy machinery results in the customer having a valid expectation that it will do so again. Consequently, the SME assesses whether the maintenance service is distinct from the machinery in accordance with paragraphs 23.18–23.22.

23.17 A promise does not include activities that an entity must undertake to fulfil a contract, such as set-up activities and administrative tasks, unless those activities transfer a good or service to a customer. Non-refundable fees charged to customers at or near the start of a contract often relate to activities that do not transfer a good or service to the customer and, therefore, do not give rise to a promise. In such cases, the non-refundable upfront fee is included in the transaction price and allocated to the promises in the contract in accordance with Steps 3 and 4.

Educational notes

The definition of a promise in paragraph 23.14 requires a good or service to be transferred. Therefore, a promise exists only if an entity transfers a good or service to a customer.

When identifying promises in a contract, an entity disregards activities that do not transfer a good or service to a customer. This is the case even if the entity charges the customer for such activities. A common example is non-refundable upfront fees charged as compensation for the costs associated with set-up activities. An entity is often required to undertake these activities at or near the start of the contract to fulfil the contract. However, the activities often do not relate to the transfer of a good or service to the customer.

Non-refundable upfront fees can be referred to differently depending on the nature of the contract, for example:

- joining fees in a health club membership contract;
- activation fees in a telecommunications contract;
- set-up fees in a service contract; and
- initial fees in a supply contract.

Subsequent accounting for upfront fees

In instances when non-refundable upfront fees do not relate to the transfer of a good or service, the fee is an advance payment for future goods or services. The fee is recognised as revenue when the promises in the contract are fulfilled in accordance with Steps 3 to 5 of the revenue recognition model.

Upfront fees and renewal options

Entities often charge customers for set-up activities when they first enter into a contract. Entities often agree to waive such future charges if the contract is subsequently renewed (that is, the customer can renew the contract without paying such charges again). By agreeing to waiving such future charges, the entity might grant customers a renewal option that is accounted for as a separate promise in accordance with paragraphs 23A.8–23A.13.

Example—Non-refundable upfront fee

Ex 15 An SME enters into a contract with a customer for one year of transaction processing services. The SME charges the customer an upfront fee for setting up the customer on the SME's systems and processes. The fee is non-refundable. The SME's set-up activities do not transfer a good or service to the customer.

The non-refundable upfront fee does not give rise to a promise. The fee is an advance payment for future transaction processing services. Consequently, the SME determines the transaction price, which includes the fee, and recognises revenue for the transaction processing services as those services are transferred to the customer.

Distinct goods or services

23.18 A good or service is distinct if both of these criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources readily available to the customer. A good or service that an entity regularly sells separately is an example of a good or service that meets this criterion.

(b) the entity's obligation to transfer the good or service is separate from other obligations in the contract.

23.19 If a good or service promised to the customer is not distinct, an entity shall combine that good or service with other goods or services in the contract until it identifies a bundle of goods or services that is distinct. In some cases, the entity will account for all the goods or services in a contract as a single promise.

Educational notes

The criteria in paragraph 23.18 focus on:

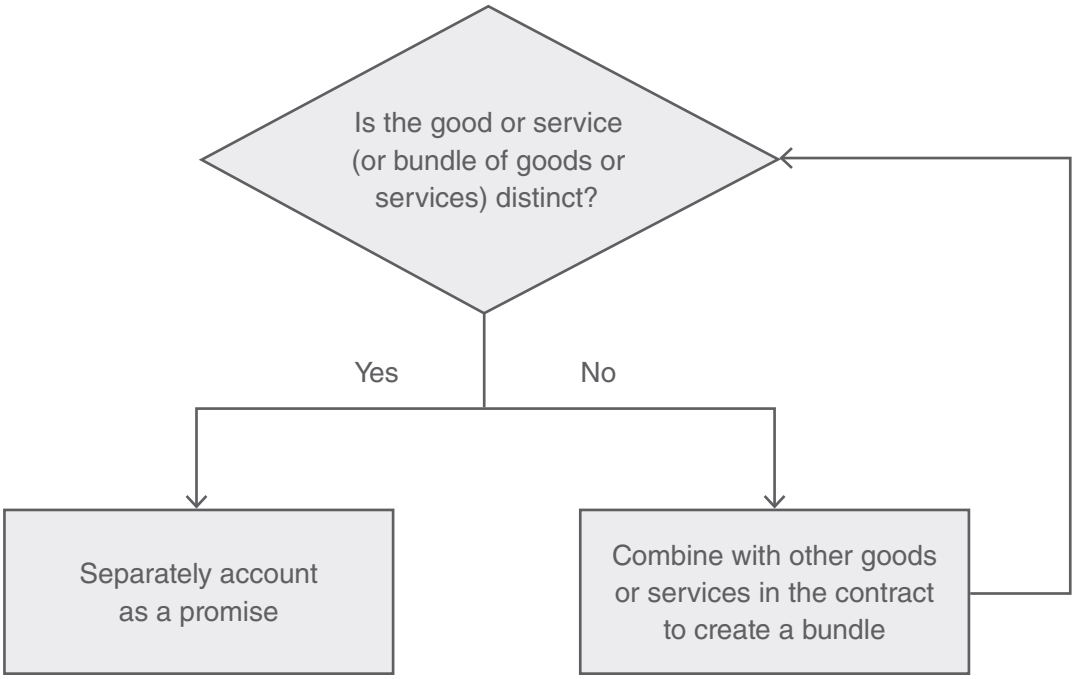
- whether a good or service is capable of being distinct (paragraph 23.18(a)); and
- whether the good or service is distinct within the context of the contract (paragraph 23.18(b)).

As shown in Figure 4, paragraphs 23.18–23.19 are repeated until all goods or services in the contract are either:

- identified as distinct (and therefore separately accounted for as a promise); or
- combined with another good or service to form a bundle that is identified as distinct (and therefore separately accounted for as a promise).

An entity would account for all the goods or services in a contract as a single promise if it determines that none of those goods or services are distinct, but combined they form a distinct bundle.

Figure 4—Accounting for distinct goods or services



Distinct goods or services

23.18 A good or service is distinct if both of these criteria are met:

(a) the customer can benefit from the good or service either on its own or together with other resources readily available to the customer. A good or service that an entity regularly sells separately is an example of a good or service that meets this criterion.

...

23.20 For the purpose of applying the criterion in paragraph 23.18(a), resources readily available to the customer are:

(a) goods or services sold separately, by the entity or another entity; or

(b) goods or services the customer has already obtained from the entity, including goods or services transferred to the customer under the contract, or from other transactions or events.

Educational notes

The criterion in paragraph 23.18(a) focuses on whether a good or service has value to the customer on a stand-alone basis, and is therefore capable of being distinct. Goods and services are usually capable of being distinct, so the criterion is usually met.

The example in paragraph 23.18(a) of goods or services that an entity regularly sells separately provides a simple test for determining whether the criterion is met. The criterion can still be met for goods or services that an entity does not sell separately. For example, an entity might choose not to sell a good or service separately solely for commercial reasons. An example of this would be if an entity requires all customers to purchase an item of machinery with training on how to operate the machinery. The entity might sell the machinery and training together only to increase sales, and not because it is necessary for a customer to be trained to operate the machinery.

The assessment of whether a customer can benefit from a good or service on its own is based on the characteristics of the good or service, instead of the way the customer might use the good or service. Consequently, an entity's assessment is based on a notional customer, and not on facts or circumstances specific to each customer.

For example, an entity may sell goods to customers who typically benefit from the goods by using them. However, the fact that a customer could generate economic benefit by reselling the goods, instead of using them, would be relevant to the entity's assessment of whether the customer can benefit from the good on its own. An example of this would be if an entity requires all customers to purchase an item of machinery with training because it is necessary for a customer to be trained to operate the machinery. Although the machinery cannot be used by the customer before the customer receives the training, the entity might be able to generate economic benefit from the machinery by reselling it. If an entity can generate economic benefit in this way, the criterion in paragraph 23.18(a) is met.

Examples—Capable of being distinct

Ex 16 An SME enters into a contract with a customer to license software and provide technical support on how to use the software for two years. The software is delivered before the SME begins to provide the technical support and is functional even without the technical support.

The customer can benefit from the software without the technical support. The customer can benefit from the technical support together with the software at the start of the contract. The SME concludes that the customer can benefit from the software and support service on their own or with other resources readily available to the customer, so the criterion in paragraph 23.18(a) is met.

Ex 17 An SME enters into a contract with a customer to manufacture and install an item of machinery. The machinery is functional only after it has been installed. The specialist nature of the machinery means only the SME can provide the installation service. The installation service is provided once the machinery has been manufactured. There are no restrictions preventing the customer from reselling the machinery before it is installed.

Because the machinery is only functional once it has been installed by the SME, the customer cannot benefit from the machinery by using it on its own or together with other resources readily available to the customer. However, because the customer could benefit from the machinery on its own by reselling it, the SME concludes that the criterion in paragraph 23.18(a) is met.

Ex 18 An SME enters into a contract with a customer to supply and fit a window. The SME does not allow customers to buy windows without them being fitted by the SME. Similarly, the SME does not fit windows that customers have bought from other entities. The fitting service can be provided by other entities.

Because the fitting service can be provided by other entities, the customer can benefit from the window without it being fitted by the SME. The customer can also benefit from the fitting service provided by the SME together with the window transferred at the start of the contract. The SME concludes that the customer can benefit from the window and fitting service on their own or with other resources readily available to the customer, so the criterion in paragraph 23.18(a) is met.

Distinct goods or services

23.18 A good or service is distinct if both of these criteria are met:

…

(b) the entity's obligation to transfer the good or service is separate from other obligations in the contract.

…

23.21 For the purpose of applying the criterion in paragraph 23.18(b), factors that suggest that the entity's obligation to transfer a good or service is not separate from other obligations in the contract include:

(a) the entity integrating the goods or services in the contract in a way that transforms them into a combined output (or outputs) for which the goods or services are inputs. For example, a construction contract in which an entity provides a contract management service that integrates various goods or services in a way that transforms them into the asset or assets to be constructed.

(b) the good or service being modified or customised by another good or service in the contract to the extent it is transformed. For example, a contract in which an entity promises to provide existing software and to customise that software, if the customisation service transforms the software.

(c) the good or service being highly dependent on, highly related to or highly affected by another good or service in the contract. For example, in some cases, two or more goods or services are highly affected by each other because an entity would not be able to fulfil its promise by transferring each of the goods or services separately.

Educational notes

The criterion in paragraph 23.18(b) focuses on whether a good or service is distinct within the context of the contract.

The three factors in paragraph 23.21 are based on the same concept: goods or services are distinct if the risks of transferring goods or services are separable. Consequently, more than one factor might apply to an entity's obligation to transfer a good or service. However, some factors are more relevant to some industries compared to others.

Integration of goods or services in the contract (paragraph 23.21(a))

The factor in paragraph 23.21(a) applies if an entity integrates the goods or services into a combined output and, as a consequence, the goods or services are transformed. A transformative relationship is different to a functional relationship. Goods and services have a functional relationship if one good or service, by its nature, depends on another to work but the goods and services remain unchanged. However, goods or services might have a transformative relationship if the nature, form or value of the goods or services are changed in the process of fulfilling the contract.

The factor is relevant in contracts where goods or services (the inputs) are combined to produce an output that is greater than the sum of the individual goods or services (that is, combining the inputs provides additional functionality). The factor often applies to construction contracts in which an entity provides an integration service by managing and co-ordinating the various construction tasks and assuming the risks associated with the integration of those tasks. In these contracts, a substantial part of the service to the customer is often to ensure the individual goods or services are appropriately integrated into the combined output.

Modification or customisation of goods or services in the contract (paragraph 23.21(b))

The factor in paragraph 23.21(b) applies when fulfilling the contract requires one good or service to be modified or customised by another, to the extent the good or service is transformed.

If one good or service transforms another, then the goods or services form a combined output and have a transformative relationship where the one good or service transforms another. The factors in paragraph 23.12(a)–(b) are similar in this respect.

The factor in paragraph 23.21(b) often applies to contracts in which an entity is providing a good or service based on a customer's specification (for example, a bespoke item).

Highly dependent on, highly related to or highly affected by another good or service (paragraph 23.21(c))

The factor in paragraph 23.21(c) applies if a customer could not choose to purchase one good or service without significantly affecting the other goods or services in the contract.

The factor might apply in scenarios in which it is unclear whether an entity is providing an integration service, or whether the goods or services are modified or customised.

Example—Goods or services are not distinct (integration service)

Ex 19 An SME enters into a contract with a customer to produce an event. To produce the event, the SME must rent a location and equipment and provide event production services (lighting design, sound engineering and stage management).

The SME concludes that the criterion in paragraph 23.18(a) is met for the transfer of the various rental and event production services.

To produce the event, the SME provides a service of managing and co-ordinating the various rental and event production services (the inputs). Doing so transforms the services into an event (the combined output) that has a value to the customer that is greater than the sum of the individual services. Therefore, the SME concludes that the obligations to provide the services are not separate from each other and the criterion in paragraph 23.18(b) is not met.

Consequently, the SME accounts for the transfer of the various rental and event production services as a single promise.

Example—Goods or services are not distinct (modified or customised)

Ex 20 An SME enters into a contract with a customer to sell and install an item of machinery. As part of the installation service, the SME will customise the machinery so it can operate as part of the customer's existing production process.

The SME concludes that the criterion in paragraph 23.18(a) is met for the transfer and installation of the machinery.

The installation service customises the machinery, which transforms it into an item of equipment that operates as part of the customer's existing production process. Therefore, the SME concludes that the obligation to install the machinery is not separate from the obligation to transfer the machinery and the criterion in paragraph 23.18(b) is not met.

Consequently, the SME accounts for the transfer and installation of the machinery as a single promise.

Example—Goods or services are not distinct (highly dependent)

Ex 21 An SME enters into a contract with a customer to design a new product and manufacture 10 prototypes of that product. The SME expects that it will need to revise the design of the product as the prototypes are being manufactured.

The SME concludes that the criterion in paragraph 23.18(a) is met for the design and manufacture of the products.

The services in the contract are highly dependent on each other because the SME is not able to purchase only the design service or only the manufacturing service without significantly affecting the other service. Therefore, the SME concludes that the obligation to design the products is not separate from the obligation to manufacture the products and the criterion in paragraph 23.18(b) is not met.

Consequently, the SME accounts for the design and manufacture of the products as a single promise.

Examples—Goods or services are distinct

Ex 22 **An SME enters into a contract with a customer to sell a product and provide maintenance services for two years. The SME regularly sells the product on a stand-alone basis (that is, without maintenance services).**

The SME concludes that the criterion in paragraph 23.18(a) is met for the product and maintenance services.

Based on the factors in paragraph 23.21, the SME concludes that the criterion in paragraph 23.18(b) is met for the product and maintenance services because:

- providing the product and maintenance services together does not result in any additional functionality. This fact suggests that the product and maintenance services are not inputs that are integrated and transformed into a combined output (paragraph 23.21(a)).
- neither the product nor the services modify or customise the other (paragraph 23.21(b)).
- the SME could transfer the product without the maintenance services (or could provide maintenance services without the product). This fact suggests the product and maintenance services are not highly dependent on, highly related to or highly affected by each other (paragraph 23.21(c)).

Consequently, the SME accounts for the product and maintenance services as separate promises.

Ex 23 **An SME enters into a contract with a customer to sell a product and provide a training course on how to operate the product. The SME regularly sells the product on a stand-alone basis (that is, without the training course).**

The SME concludes that the criterion in paragraph 23.18(a) is met for the product and training course.

Based on the factors in paragraph 23.21, the SME concludes that the criterion in paragraph 23.18(b) is met for the product and training course because:

- providing the product and training course together does not result in any additional functionality. This fact suggests that the product and training course are not inputs that are integrated and transformed into a combined output (paragraph 23.21(a)).
- the training course will be customised so it is specific to the product sold. However, it is the SME, not the product, that will customise the training course. Similarly, the training course will not modify or customise the product (paragraph 23.21(b)).
- the SME could transfer the product without the training course (or could provide the training course without the product). This fact suggests the product and training course are not highly dependent on, highly related to or highly affected by each other (paragraph 23.21(c)).

Consequently, the SME accounts for the product and training course as separate promises.

Ex 24 **An SME enters into a contract with a customer to sell a printer and supply ink cartridges to be used in the printer each month for the next three years. The cartridges are produced only by the SME. The SME sells the cartridges separately as well as part of a subscription.**

The SME concludes that the criterion in paragraph 23.18(a) is met for the printer and cartridges.

Based on the factors in paragraph 23.21, the SME concludes that the criterion in paragraph 23.18(b) is met for the printer and cartridges because:

- although the printer depends on the cartridges to function, the cartridges do not transform the equipment and cartridges into a combined output. The SME also does not provide any service that integrates the printer and cartridges in transferring both inputs (paragraph 23.21(a)).
- neither the printer nor the cartridges modify or customise the other (paragraph 23.21(b)).
- although the customer cannot benefit from the cartridges without the printer, the SME is still able to transfer the cartridges without the printer, and the printer without the cartridges. This fact suggests the printer and cartridges are not highly dependent on, highly related to or highly affected by each other (paragraph 23.21(c)).

Consequently, the SME accounts for the printer and cartridges as separate promises.

23.22 Distinct goods or services can include:

(a) warranties (see paragraphs 23A.5–23A.7);

(b) options to acquire additional goods or services (see paragraphs 23A.8–23A.13);

(c) arranging for another party to transfer goods or services to the customer if the entity is acting as an agent (see paragraphs 23A.14–23A.20); and

(d) licences (see paragraphs 23A.28–23A.37).

Educational notes

The list of goods or services in paragraph 23.22 is not exhaustive and includes those covered by requirements in the Appendix to Section 23.

The requirements in the appendix specify circumstances in which warranties and options to acquire additional goods or services are accounted for as separate promises, and therefore relevant when an entity applies Step 2.

Step 3—Determine the transaction price

Educational notes

The transaction price for a contract is determined in Step 3 of the revenue recognition model. In Step 4 the transaction price is allocated to the promises identified in Step 2. The allocated transaction price is then recognised as revenue in Step 5.

The requirements in Step 3 determine how an entity measures the transaction price and include specific requirements on:

- variable consideration (see paragraphs 23.26–23.35);
- deferred payment (see paragraphs 23.36–23.38); and
- non-cash consideration (see paragraphs 23A.21–23A.22).

23.23 The transaction price is the amount of consideration an entity expects to be entitled to in exchange for transferring goods or services promised to a customer, excluding amounts the entity collects on behalf of third parties (for example, some sales taxes).

Educational notes

Consideration an entity expects to be entitled to compared with consideration it expects to receive

The amount of consideration an entity expects to be entitled to is the amount of consideration included in the transaction price and recognised as revenue.

The amount of consideration an entity expects to be *entitled to* might not be the same as the amount of consideration that the entity expects to *receive*. For example, if the financial situation of a customer deteriorates as the contract progresses, an entity might expect to receive an amount of consideration that is less than the amount of consideration to which it is entitled. Such differences are not considered when measuring the transaction price and recognising revenue and are instead recognised as impairment losses on contract assets and trade receivables in accordance with Section 11 *Financial Instruments*.

Amounts collected on behalf of third parties

An entity excludes from the transaction price amounts of consideration that it collects on behalf of third parties. These amounts are excluded from the transaction price (and not recognised as revenue) because they do not relate to the entity's performance in transferring goods or services to a customer.

Consideration collected on behalf of third parties includes:

- sales tax, goods or services taxes and value added taxes levied on customers that an entity collects on behalf of a government; and

- consideration that an entity collects on behalf of a principal (if the entity is an agent—see paragraphs 23A.14–23A.20).

Example—Differences between amount of consideration to which an entity expects to be entitled and amount it expects to receive

Ex 25 **An SME enters into a contract to transfer a product to a customer. Revenue is recognised when the customer accepts delivery of the product. Payment is due within 60 days of delivery.**

The day after delivery, the customer's business is destroyed by a natural disaster and the SME expects to receive only 20% of the selling price on liquidation of the customer.

The transaction price is the amount of consideration the SME expects to be entitled to in exchange for transferring the product to the customer. This is the amount agreed with the customer before the product is delivered. The SME recognises this amount as revenue (and a trade receivable) when the customer accepts the delivery.

The trade receivable is tested for impairment in accordance with Section 11. The transaction price and the amount recognised as revenue are unaffected by the impairment.

Examples—Amounts collected on behalf of third parties

Ex 26 **An SME sells a good for CU100, including CU10 of sales tax levied on customers that the SME collects on behalf of the government.**

The SME collects the CU10 of sales tax on behalf of the government and therefore excludes this amount in determining the transaction price, meaning that the transaction price is CU90 (CU100 – CU10).

Ex 27 **An agent sells goods to customers on behalf of a manufacturer.**

The manufacturer instructs the agent to sell the goods at CU100 per unit. The agent deducts a fixed commission of CU5 for each unit sold and transfers the balance (CU100 – CU5 = CU95) to the manufacturer.

When the agent determines the transaction price, it excludes the CU95 collected on behalf of the manufacturer (the principal).

When the CU95 is received (or receivable), the agent records it as an amount payable to the principal (a liability).

23.24 An entity shall determine the transaction price based on the terms of the contract and its usual business practices. When determining the transaction price, an entity shall assume the goods or services will be transferred to the customer in accordance with the contract. The entity shall also assume the contract will not be cancelled, renewed or modified.

Educational notes

An entity is required to determine the transaction price from the information in the contract and how the entity normally conducts its business.

The price stated in the contract is typically the list price (advertised price) of the good or service or the price negotiated between the entity and the customer. The price stated in the contract might be different from the amount of consideration the entity expects to be entitled to (the transaction price) if the consideration is variable or payment of the consideration is deferred.

An entity does not factor in expectations about contract cancellations, renewals or modifications when it determines the transaction price.

23.25 If the consideration promised by the customer is in a form other than **cash**, an entity shall measure the non-cash consideration by applying paragraphs 23A.21–23A.22.

Educational notes

A customer might promise to pay consideration in a form other than cash, such as goods or services. The Appendix to Section 23 includes requirements for measuring non-cash consideration.

Variable consideration

23.26 The consideration promised by a customer might vary because of factors such as discounts, rebates, refunds, penalties or performance bonuses.

Educational notes

If the amount of consideration that an entity will be entitled to depends on the occurrence of a future event, the consideration is variable.

Paragraph 23.26 lists common types of variable consideration:

- *discounts*—for example, a prompt settlement discount in which the amount of consideration varies depending on when the customer pays;
- *rebates*—for example, a volume rebate in which the amount of consideration varies depending on the volume of goods or services the customer orders;

- *refunds*—for example, a product sold with a right of return in which the amount of consideration varies depending on whether the customer returns the product;
- *penalties*—for example, a late penalty in which the amount of consideration varies depending on when the entity transfers the good or service; and
- *performance bonuses*—for example, a bonus in which the amount of consideration varies depending on whether the conditions of the bonus are met.

Depending on their terms, contracts could have different amounts of time between:

- the entity transferring the goods or services to the customer; and
- the time at which the uncertainty about the variable consideration is resolved.

In some contracts the uncertainty might not be resolved for a long period after the goods or services are transferred (for example, a bonus based on a customer's performance one year after the delivery of an item of equipment). If the uncertainty is resolved before the end of the reporting period, it is not necessary for an entity to estimate the amount of variable consideration. No estimation is necessary because the entity knows the amount of variable consideration it is entitled to based on conditions that existed at the end of the reporting period. Therefore, the entity includes this amount of variable consideration in the transaction price instead of an estimate.

The proportion of consideration that is variable also differs depending on the terms of a contract. For example:

- in a contract in which the customer is offered a prompt settlement discount of 10% if it pays within 14 days of the good or service being transferred, 10% of the amount of consideration is variable; and
- in a contract in which the customer has a right to a full refund if it is dissatisfied with the good or service transferred, the entire amount of consideration is variable.

23.27 If the consideration includes a variable amount, an entity shall measure the amount of variable consideration to include in the transaction price by:

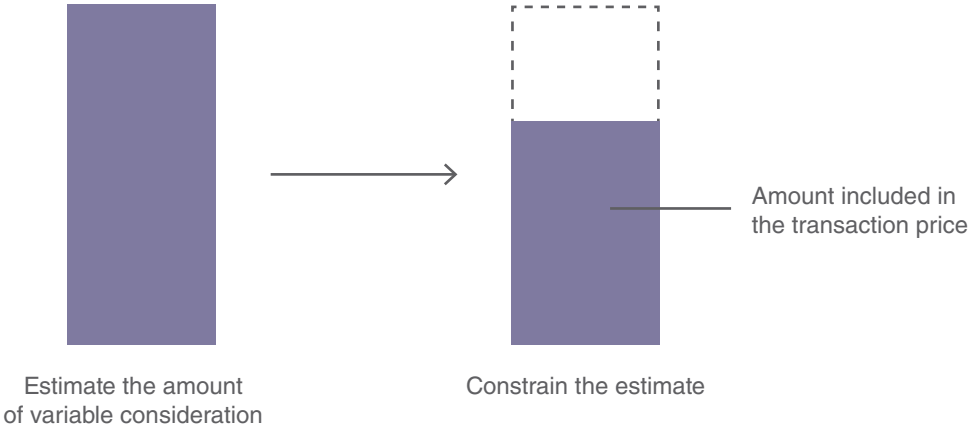
(a) estimating the amount of variable consideration (see paragraphs 23.28–23.29); and

(b) constraining that estimate (see paragraph 23.30).

Educational notes

Paragraph 23.27 lists the two steps an entity applies to measure variable consideration at the beginning of a contract. In the first step, the entity estimates an unconstrained amount of variable consideration (referred to as the gross estimate). In the second step, the entity then constrains that estimate. The constrained estimate is the amount of variable consideration included in the transaction price. Figure 5 shows how these steps come to the amount of variable consideration included in the transaction price.

Figure 5—Requirements for measuring variable consideration



23.28 An entity shall estimate an amount of variable consideration by using one of two methods:

(a) the expected value method—the sum of probability-weighted amounts in a range of possible consideration amounts. This might be an appropriate method if an entity has many contracts with similar characteristics.

(b) the most likely amount method—the most likely amount in a range of possible consideration amounts (that is, the most likely outcome of the contract). This might be an appropriate method if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

Educational notes

Choosing a method

The gross estimate of variable consideration is measured using:

- the expected value method; or
- the most likely amount method.

Entities can choose either method, however, paragraph 23.28 describes scenarios when each method might be appropriate.

Applying these methods in the way described by paragraph 23.28 helps entities come to a reasonable estimate in a straightforward way. For example, an entity that uses the most likely amount method when a contract has only two possible outcomes can avoid having to attribute a probability to each outcome. Regardless of which method an entity uses, it should ensure the method provides an estimate that reflects the amount of consideration to which it expects to be entitled.

Applying a method—Judgement

Measuring the gross estimate of variable consideration requires judgement. The estimate is based on the amount of consideration to which the entity will be entitled. In measuring this gross estimate, the entity should not consider whether the amount is reliable enough to be recognised as revenue. The entity considers whether the amount is reliable enough to be recognised as revenue when it applies the constraint on the estimate of variable consideration in paragraph 23.30.

Applying a method—Considering all possible outcomes

When identifying the most likely amount, an entity is not be expected to quantify less-probable outcomes to identify the most likely outcome. Similarly, an entity is not expected to base its estimate of the expected value on all possible outcomes. In many cases, a limited number of discrete outcomes and their probabilities can provide a reasonable estimate of the distribution of possible outcomes.

Example—Measuring the gross estimate, most likely amount method (performance bonus)

Ex 28 An SME constructs buildings for customers.

The SME enters into a contract with a customer to build an office. If the building is complete within 18 months, the SME will be entitled to a performance bonus of CU5,000, in addition to fixed consideration of CU20,000.

The contract has two possible outcomes: the SME will achieve the performance bonus or it will not. Therefore, the SME decides to measure the gross estimate of variable consideration using the most likely amount method.

Based on the SME's assessment of its construction schedule and experience with similar contracts, it concludes that the most likely outcome is that it will achieve the performance bonus.

Therefore, the gross estimate equals CU5,000.

Example—Measuring the gross estimate, expected value method (penalties)

Ex 29 An SME refurbishes offices for customers.

The SME enters into a contract with a customer to refurbish an office for CU40,000. The contract requires the offices to be refurbished within four months. If the office is not refurbished within four months, the promised consideration is reduced by CU5,000 each week the office remains unfurnished. The maximum reduction in consideration is CU40,000, which would occur if the refurbishment were delayed by eight weeks or more.

The entire amount of consideration is variable because the entire amount of the consideration could be reduced by the penalty.

The contract has a range of possible outcomes depending on when the SME completes the refurbishment. Many of the SME's contracts to refurbish offices include weekly penalties for delays. Therefore, the SME decides to measure the gross estimate of variable consideration using the expected value method. Based on the SME's assessment of its refurbishment schedule and experience with similar contracts, it concludes that it is very unlikely the refurbishment will be more than five weeks late and does not quantify these outcomes. The probabilities estimated for the remaining outcomes are as follows:

Number of weeks late	Reduction in consideration	Probability of occurrence
	CU	
0 (completed on time)	–	40%
1	5,000	28%
2	10,000	15%
3	15,000	9%
4	20,000	5%
5	25,000	3%

Therefore, the estimated penalty equals CU6,000 ((CU5,000 × 28%) + (CU10,000 × 15%) + (CU15,000 × 9%) + (CU20,000 × 5%)) and the gross estimate equals CU34,000 (CU40,000 – CU6,000).

Example—Measuring the gross estimate, expected value method (discount)

Ex 30 An SME sells its products on credit.

The SME awards customers a 10% early settlement discount provided that the customer pays within 30 days of buying the goods.

In the last 30 days of the reporting period, the SME entered into 100 contracts with 100 customers for one unit of Product A at CU100 per unit.

There are two possible outcomes for the contracts: the customer will either be awarded the early settlement discount or it will not. However, because the contracts have similar characteristics, the SME decides to measure the gross estimate using the expected value method.

Based on evidence of the type of products sold and class of customers, the SME concludes that 50% of customers will be awarded the early settlement discount.

Therefore, the gross estimate equals CU500 ((100 × CU100) × 10% × 50%).

Example—Measuring the gross estimate, expected value method (rebate)

Ex 31 An SME awards customers rebates based on their annual purchases.

For Good A, the SME offers customers the following per-unit rebate:

Total units purchased	Per-unit rebate
0–5,000	5%
5,001–10,000	10%
10,001–15,000	15%
15,000+	20%

The SME will enter into many similar contracts to sell Good A during the reporting period. Therefore, the SME decides to measure the gross estimate using the expected value method.

Based on the SME's predicted sales figures, it expects customers to purchase Good A during the current reporting period according to the following distribution:

Total units purchased	Customers
0–5,000	47%
5,001–10,000	33%
10,001–15,000	18%
15,000+	2%

Therefore, based on the SME's expectations, it estimates the rebate to be 8.75% per unit ((47% × 5%) + (33% × 10%) + (18% × 15%) + (2% × 20%)).

Because the variable consideration is recognised as each unit is sold, the SME does not need to estimate the total variable consideration based on the total units it expects to sell at the start of the reporting period.

23.29 An entity shall apply one method to estimate the amount of variable consideration consistently throughout the contract.

Educational notes

The method an entity uses to estimate an amount of variable consideration is required to be applied consistently throughout the contract. However, an entity can use different methods in contracts that include more than one type of variable consideration if the uncertainties associated with each type of consideration are different.

For example, an entity could use different methods in a contract that includes a prompt-payment discount and a performance bonus. The uncertainty associated with the prompt-payment discount is related to the customer's actions and has many possible consideration amounts depending on when the customer pays. However, the uncertainty associated with the performance bonus is related to the entity's performance and has only two possible outcomes. Because the uncertainties associated with each type of variable consideration in the example are different, the entity might use:

- the expected value method to estimate the amount of variable consideration associated with the prompt-payment discount; and
- the most likely amount method to estimate the amount of variable consideration associated with the performance bonus.

23.30 An entity shall include in the transaction price an amount of variable consideration estimated in accordance with paragraph 23.28 only to the extent that it is **highly probable** that an entity will become entitled to this amount when the uncertainty associated with the variable consideration is later resolved.

Educational notes

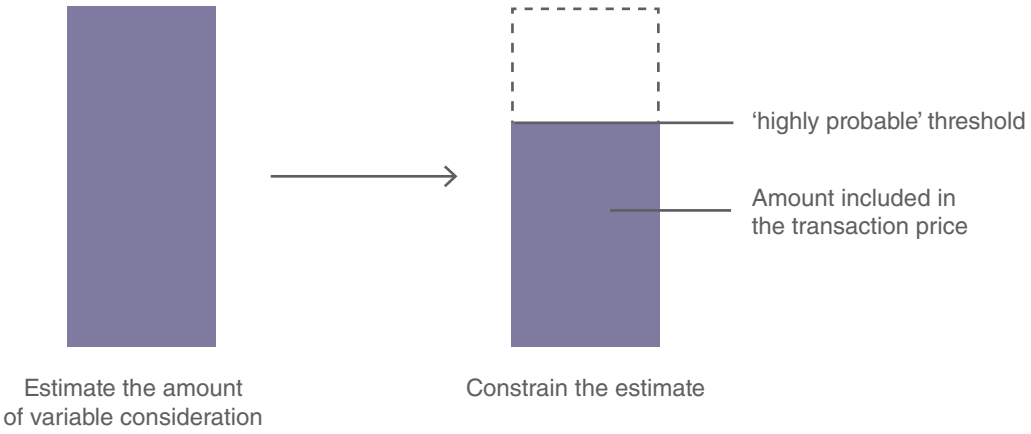
An entity is required to constrain the gross estimate of variable consideration. The entity includes the constrained estimate in the transaction price and recognises it as revenue.

The gross estimate is constrained to avoid entities having to make significant reversals to the amount of cumulative revenue recognised in future periods.

Constraining the estimate

The gross estimate is included in the transaction price only if it is 'highly probable that an entity will become entitled to this amount when the uncertainty associated with the variable consideration is later resolved'. Therefore, the amount of the gross estimate included in the transaction price is required to meet this threshold (as shown in Figure 6).

Figure 6—Variable consideration included in the transaction price



Depending on how certain an entity is that it will become entitled to the gross estimate, it might include in the transaction price:

- none of the gross estimate (if the entire estimate is constrained).
- some of the gross estimate.
- all of the gross estimate (if none of the estimate is constrained). This would be the case if an entity's measurement of the gross estimate had already factored in the 'highly probable' threshold.

Applying the constraint—Threshold

The threshold for including the gross estimate in the transaction price uses the term 'highly probable'.

The Glossary defines highly probable as 'significantly more likely than probable' and defines probable as 'more likely than not'.

Applying the constraint—Judgement

Applying the constraint requires judgement. Determining whether an entity will become entitled to an amount of consideration will be more difficult if:

- the amount of consideration is highly susceptible to factors outside the entity's influence (for example, judgements or actions of third parties or external factors such as weather conditions);
- the uncertainty about the amount of consideration is not expected to be resolved for a long period;
- the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value; or
- the contract has a large number and broad range of possible consideration amounts.

In such instances, the entity is more likely to constrain the gross estimate.

Example—Constraining the estimate of variable consideration, the estimate is constrained (performance bonus)

Ex 32 The facts are the same as in Example 28. That is, an SME constructs buildings for customers.

The SME enters into a contract with a customer to build an office. If the building is complete within 18 months, the SME will be entitled to a performance bonus of CU5,000, in addition to fixed consideration of CU20,000.

At the start of the contract, the SME measures the gross estimate as CU5,000 (see Example 28). The estimate is based on the SME concluding that the most likely outcome is that it will achieve the performance bonus.

Although the SME concludes that the most likely outcome is that it will achieve the performance bonus, the uncertainty about the bonus will not be resolved within 12 months and is susceptible to factors outside the SME's influence (for example, weather conditions that could affect the delivery of materials and the performance of subcontractors). The factors mean there is a high level of uncertainty associated with the SME achieving the bonus, despite experience and evidence from the building schedule indicating the bonus will be achieved.

Because of the high level of uncertainty, the SME is of the view that achieving the performance bonus is probable, but not highly probable. Based on this assessment, the SME concludes that the gross estimate of CU5,000 would not meet the threshold in paragraph 23.30. Therefore, the SME includes none of the gross estimate of CU5,000 in the transaction price (that is, the SME constrains the entire estimate).

Example—Constraining the estimate of variable consideration, part of the estimate is constrained (penalties)

Ex 33 The facts are the same as in Example 29. That is, an SME refurbishes offices for customers.

The SME enters into a contract with a customer to refurbish an office for CU40,000. The contract requires the offices to be refurbished within four months. If the office is not refurbished within four months, the promised consideration is reduced by CU5,000 each week the office remains unfurnished. The maximum reduction in consideration is CU40,000, which would occur if the refurbishment were delayed by eight weeks or more.

At the start of the contract, the SME measures the gross estimate as CU34,000 (see Example 29).

The uncertainty about when the SME completes the refurbishment will be resolved in a short period of time. The estimation is based on the SME's experience with similar types of contracts. That experience has predictive value in determining when the refurbishment will be completed. However, the contract has several possible consideration amounts, and the time taken to complete the refurbishment is susceptible to factors outside the entity's influence (such as the availability of subcontractors).

Because of the uncertainty, the SME is unable to conclude that it is highly probable that it will be entitled to CU34,000 when the refurbishment is complete. Instead, the SME constrains the estimate to meet the threshold in paragraph 23.30, and concludes that it is highly probable that it will be entitled to CU30,000. Because the entire amount of consideration is variable, the transaction price is CU30,000.

Example—Constraining the estimate of variable consideration, the estimate is not constrained (discount)

Ex 34 The facts are the same as in Example 30. That is, an SME sells its products on credit.

The SME awards customers a 10% early settlement discount provided that the customer pays within 30 days of buying the goods.

In the last 30 days of the reporting period, the SME entered into 100 contracts with 100 customers for one unit of Product A at CU100 per unit.

At the start of the contract, the SME measures the gross estimate as CU500 (see Example 30).

The uncertainty associated with the variable consideration will be resolved in a short amount of time (within 30 days of the reporting date). The estimate is based on historical evidence which has strong predictive value.

Because of the low level of uncertainty, the SME concludes that all the CU500 would meet the threshold in paragraph 23.30. Therefore, the SME includes the whole gross estimate of CU500 in the transaction price (that is, the SME does not constrain the estimate).

Example—Constraining the estimate of variable consideration, the estimate is not constrained (rebate)

Ex 35 The facts are the same as in Example 31. That is, an SME awards customers rebates based on their annual purchases.

For Good A, the SME offers customers the following per-unit rebate:

Total units purchased	Per-unit rebate
0–5,000	5%
5,001–10,000	10%
10,001–15,000	15%
15,000+	20%

At the start of the contract, the SME estimates the rebate to be 8.75% per unit (see Example 31). Therefore, if the selling price of Good A was CU100 per unit, the transaction price would be CU91.25 (CU100 × (100% – 8.75%)).

The rebate is based on customers' annual purchases. These purchases can be highly susceptible to factors outside the SME's influence (for example, the actions of customers and competitors). Also, the total number of Good A purchased by a customer will not be known until the end of the reporting period.

Although there is uncertainty associated with the estimate, the SME concludes that it will be entitled to 91.25% of the sales price of each unit sold. This is because the SME is of the view that it is highly probable that the sales figures required for a total rebate of more than 8.75% per unit will not be exceeded. Consequently, it is highly probable that the rebate will not exceed 8.75% per unit, and the consideration the SME becomes entitled to will not decrease below 91.25% (100% – 8.75%) of the sales price of each unit sold.

Therefore, the SME concludes that all the 91.25% would meet the threshold in paragraph 23.30 and it does not constrain this estimate. The SME uses this percentage when recognising revenue from sales of Good A during the reporting period. For example, if the selling price of Good A was CU100 per unit, the transaction price would be CU91.25 (CU100 × 91.25%).

23.31 At the end of each **reporting period**, an entity shall update the amount of variable consideration included in the transaction price to reflect any relevant changes in circumstances. An entity shall allocate any subsequent changes in the transaction price to the promises in the contract on the same basis it used at the start of the contract. An entity shall recognise amounts allocated to a fulfilled promise as revenue (or as a reduction of revenue) in the period in which the estimate changes.

Educational notes

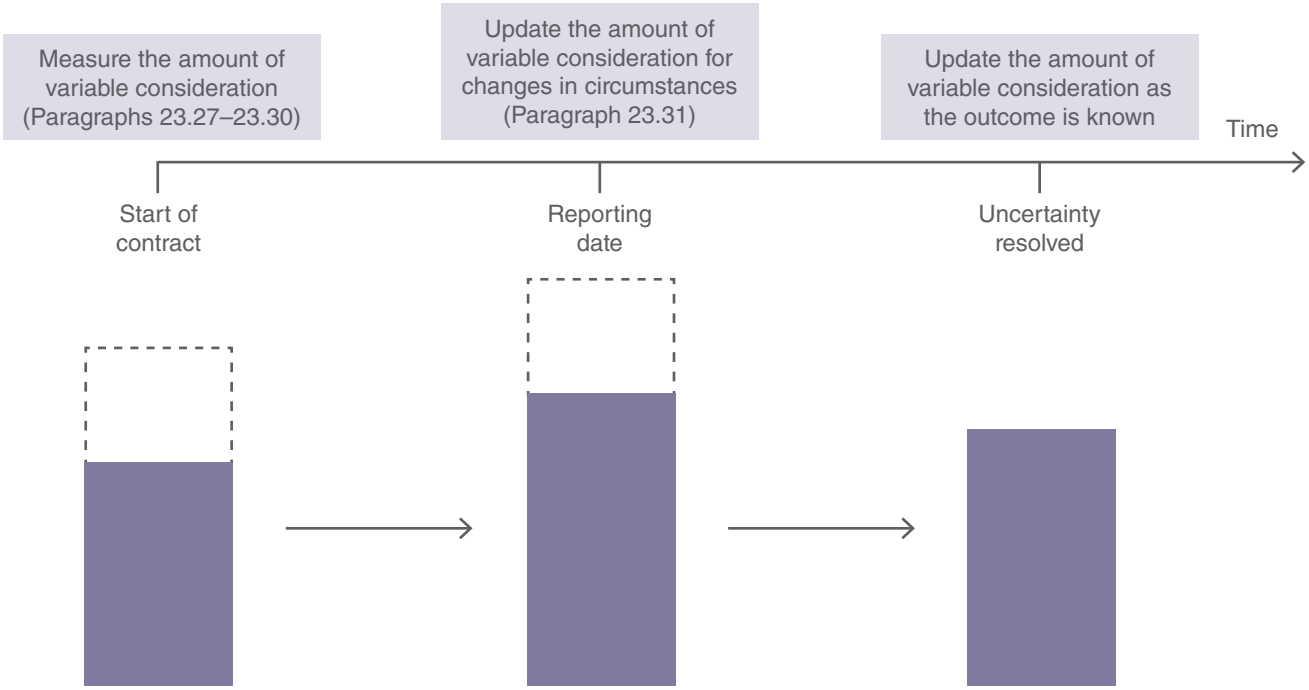
Updating the amount of variable consideration

An entity is required to update the amount of variable consideration included in the transaction price to reflect any relevant change in circumstances if the uncertainty associated with the variable consideration remains unresolved at the reporting date. Such updates change the transaction price.

'Relevant changes in circumstances' are changes that would affect an entity's measurement of variable consideration. The entity is likely to have more information about the uncertainties associated with the variable consideration at the reporting date than at the start of the contract. Therefore, the entity's measure of the variable consideration might change. For example, the entity might include more variable consideration in the transaction price than it had included at the start of the contract, because by the reporting date it can better predict the amount of consideration to which it will become entitled.

Figure 7 shows the timings for when an entity is required to measure and update the amount of variable consideration included in the transaction price during a contract.

Figure 7—Timings for measurement of variable consideration



Accounting for subsequent changes in the transaction price

If the uncertainty is resolved and the amount of variable consideration becomes known in the reporting period, the change in the transaction price is recognised at the time the uncertainty is resolved. If the amount of variable consideration included in the transaction price is updated at the end of the reporting period, the change in the transaction price is recognised at the reporting date.

When accounting for changes in the transaction price, the entity allocates the change to the promises in the contract using the stand-alone selling prices of the distinct goods or services at the start of the contract (see Example 45). In other words, the entity does not update the stand-alone selling prices (see paragraph 23.42). If the change is allocated to a promise that was fulfilled or partially fulfilled in a prior period, the change is recognised in the current period on a cumulative catch-up basis, similar to the accounting for contract modifications (see paragraph 23A.4(b)). No adjustments are made to the prior period financial statements.

The requirements for accounting for subsequent changes in the transaction price are consistent with the requirements for accounting for changes in accounting estimates in Section 10 *Accounting Policies, Estimates and Errors*.

Disclosing changes in accounting estimates

Section 10 requires an entity to disclose information about changes in accounting estimates (see paragraph 10.18).

No disclosure is necessary for contracts spanning only two reporting periods because the estimated amount of variable consideration included in the transaction price is not updated at a future reporting date and the accounting estimate does not change between reporting dates.

However, disclosure is necessary for contracts spanning more than two reporting periods if the estimated amount of variable consideration included in the transaction price changes between reporting dates.

Example—Change to transaction price (performance bonus)

Ex 36 **The facts are the same as in Examples 28 and 32. That is, an SME constructs buildings for customers.**

The SME enters into a contract with a customer to build an office. If the building is complete within 18 months, the SME will be entitled to a performance bonus of CU5,000, in addition to fixed consideration of CU20,000.

The contract spans three reporting periods, as shown in Figure 8.

Figure 8—Contract timeline

At the start of the contract, the SME measures the gross estimate as CU5,000 (see Example 28) and includes none of that amount in the transaction price (see Example 32).

At the end of 20X0, there are no changes in circumstances that cause the SME to include any of the variable consideration in the transaction price.

At the end of 20X1, the SME assesses its progress towards the building schedule and concludes the most likely outcome is that it will achieve the performance bonus. Because the contract is close to completion, there is little uncertainty that the SME will achieve the performance bonus and the SME is of the view that achieving the performance bonus is highly probable. Therefore, the SME concludes that all the CU5,000 would meet the threshold in paragraph 23.30 and includes the whole gross estimate of CU5,000 in the transaction price (that is, the SME no longer constrains the estimate).

The SME accounts for the construction of the building as a single promise fulfilled over time and uses a cost-based measure of progress. By the end of 20X0, the SME has fulfilled 10% of the promise. Consequently, the SME recognises CU2,000 (CU20,000 × 10%) as revenue in 20X0.

By the end of 20X1, the SME has fulfilled 85% of the promise. Consequently, the SME recognises CU19,250 (((CU20,000 + CU5,000) × 85%) – CU2,000) as revenue in 20X1. No adjustment is made to the amount of revenue recognised in 20X0.

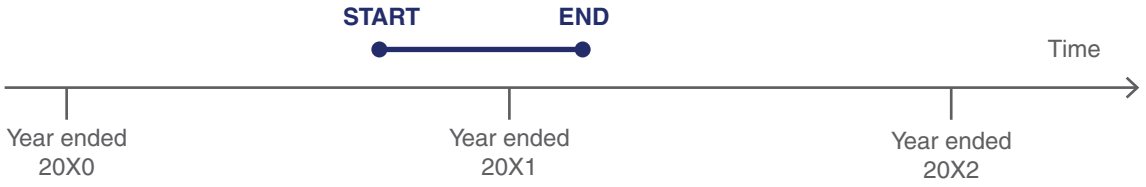
Example—Change to transaction price when uncertainty is resolved (penalties)

Ex 37 The facts are the same as in Examples 29 and 33. That is, an SME refurbishes offices for customers.

The SME enters into a contract with a customer to refurbish an office for CU40,000. The contract requires the offices to be refurbished within four months. If the office is not refurbished within four months, the promised consideration is reduced by CU5,000 each week the office remains unfurnished. The maximum reduction in consideration is CU40,000, which would occur if the refurbishment were delayed by eight weeks or more.

The contract spans two reporting periods, as shown in Figure 9.

Figure 9—Contract timeline



At the start of the contract, the SME measures the gross estimate as CU34,000 (see Example 29) and includes CU30,000 of that amount in the transaction price (see Example 33).

At the end of 20X1, the SME updates the amount of variable consideration included in the transaction price. Since the start of the contract, the SME has experienced substantial delays to its refurbishment schedule because of staff shortages. Consequently, the likelihood that the SME will complete the refurbishment late has increased. The SME updates its measure of the gross estimate and constraint of that amount, changing the transaction price to CU28,000.

The SME accounts for the refurbishment of the office as a single promise fulfilled over time and uses a time-based measure of progress. By the end of 20X0, the SME has fulfilled 60% of the promise. Consequently, the SME recognises CU16,800 (CU28,000 × 60%) of revenue in 20X1.

During 20X2, the SME completes the refurbishment three weeks late. The uncertainty associated with the variable consideration is resolved and the SME is entitled to CU25,000 (CU40,000 – (CU5,000 × 3)). Consequently, the SME recognises revenue of CU8,200 (CU25,000 – CU16,800) in 20X2. No adjustment is made to the amount of revenue recognised in 20X1.

23.32 An entity shall apply paragraph 23A.37 to account for consideration in the form of a royalty based on sales or use that is received in exchange for a licence of intellectual property.

Educational notes

Sales-based and usage-based royalties are variable consideration because the amount of the consideration an entity is entitled to varies depending on sales or use. The Appendix to Section 23 includes requirements for this type of variable consideration received in exchange for a licence of intellectual property. These requirements are different from the requirements in paragraphs 23.27–23.31.

Refund liabilities

23.33 If an entity receives consideration from a customer and expects to refund some or all of that consideration to the customer, the entity shall recognise a refund liability.

23.34 The entity shall measure a refund liability by first applying paragraphs 23.27–23.30 to measure the amount of variable consideration to include in the transaction price. The entity shall then recognise as a refund liability the amount of consideration received (or receivable) for goods or services transferred that is not included in the transaction price. At the end of each reporting period, an entity shall update the estimate of the refund liability to reflect consideration received (or receivable), goods or services transferred, and changes in the transaction price in accordance with paragraph 23.31.

23.35 As an exception to paragraph 23.34, an entity shall apply paragraphs 23A.23–23A.27 to account for the variable consideration and refund liability relating to a sale with a right of return.

Educational notes

Examples of when an entity might recognise a refund liability include:

- when a customer pays for a good or service and the entity is required to refund some or all of that consideration if specific criteria are met (for example, if the good is not transferred by a specific date or the customer becomes entitled to a volume rebate); or
- when a customer pays for a good or service and the customer has a right to a refund if they are dissatisfied with the good or service received.

An entity might also recognise a refund liability if it sells a product and gives the customer a right to a refund if they return the product. The Appendix to Section 23 includes requirements for these transactions that are different from the requirements in paragraphs 23.27–23.35.

The recognition of a refund liability is not conditional on an entity having received consideration from a customer. For example, an entity might sell a good for CU100 on credit and recognise revenue and a receivable for that amount when it transfers the good to the customer. In accordance with paragraphs 23.33–23.34, if the entity expects to refund some or all of the CU100 to the customer, it recognises a refund liability equal to the variable consideration not included in the transaction price.

Presentation—Distinguishing between refund liabilities and contract liabilities

A refund liability is recognised only if goods and services have been transferred. If an entity has received consideration (or consideration is receivable) and no goods or services have been transferred, the entity recognises a contract liability instead of a refund liability. The Glossary defines a contract liability as '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'.

Table 1 summarises when consideration received (or receivable) is recognised as revenue, a contract liability or a refund liability.

Table 1—Treatment of consideration received (or receivable) if consideration is variable

Goods or services transferred	Revenue recognised?	Liability recognised?
Consideration received (or receivable), no goods or services transferred	No	Contract liability recognised
Consideration received (or receivable), some goods or services transferred	To reflect goods or services transferred	Refund liability recognised based on goods or services transferred Contract liability recognised based on consideration received (or receivable) not recognised as revenue or a refund liability
Consideration received (or receivable), all goods and services transferred	Yes	Refund liability recognised

Example—Recognising a refund liability (right to refund)

Ex 38 An SME redecorates buildings for customers. Customers are entitled to a refund if they are dissatisfied with the SME's services within six months of the building being redecorated.

The entire amount of consideration received (or receivable) for services is variable because it could be refunded within six months.

Each contract has a range of possible outcomes depending on whether the customer is dissatisfied with the SME's services and the amount of consideration refunded. Based on the SME's experience with previous contracts, it estimates that 4% of all consideration received is refunded to customers. The SME concludes that 96% of consideration received would meet the threshold in paragraph 23.30.

At the reporting date, the SME has:

- contracts in which the six-month refund period has ended;
- contracts in the six-month refund period; and
- contracts in which the redecoration is in progress.

For contracts in which the six-month refund period has ended, the SME recognises no refund liability because the uncertainty associated with the variable consideration is resolved.

For contracts in the six-month refund period, the SME recognises a refund liability of 4% of the consideration received or receivable.

For contracts in which the redecoration is in progress, the SME recognises a receivable for services transferred during the reporting period because it has an unconditional right to consideration for those services. The SME recognises a refund liability for the services transferred of 4% of the consideration received or receivable.

Example—Recognising a refund liability (good must meet specific criteria)

Ex 39 An SME enters into a contract with a customer to build a customised asset for CU12,000. Upon completion of the asset, a third party will inspect the asset and assign an A or B rating based on metrics that are defined in the contract. If the asset receives the B rating, the promised consideration will be reduced by CU5,000.

At the reporting date, the SME has built the asset and has received CU12,000 from the customer, but the inspection of the asset has not yet happened. If the asset receives the B rating, the SME will have to refund the customer CU5,000.

The contract has two possible outcomes: the asset could be assigned an A or B rating. Therefore, the SME estimates the amount of variable consideration using the most likely amount method.

Based on the SME's assessment of the metrics and experience with similar contracts, it concludes that the most likely outcome is that the asset will be assigned the A rating. The SME estimates the variable amount as CU5,000. The SME then concludes that all the CU5,000 would meet the threshold in paragraph 23.30 and includes the whole gross estimate of CU5,000 in the transaction price (that is, the SME does not constrain the estimate). Because all the variable consideration is included in the transaction price, the SME does not recognise a refund liability.

Example—Recognising a refund liability (penalty payments)

Ex 40 The facts are the same as in Examples 29, 33 and 37. That is, an SME refurbishes offices for customers.

The SME enters into a contract with a customer to refurbish an office for CU40,000. The contract requires the offices to be refurbished within four months. If the office is not refurbished within four months, the promised consideration is reduced by CU5,000 each week the office remains unfurnished. The maximum reduction in consideration is CU40,000, which would occur if the refurbishment were delayed by eight weeks or more.

The SME receives CU40,000 at the start of the contract.

At the start of the contract, the transaction price is estimated at CU30,000 (see Example 33). Because no goods or services have been transferred, the SME does not recognise any refund liability. Instead, the SME recognises the upfront payment of CU40,000 as a contract liability.

At the end of 20X0, the transaction price is estimated at CU28,000 (see Example 37). By the end of 20X0, the SME has fulfilled 60% of the promise. Consequently, the SME recognises CU16,800 (60% × CU28,000) of revenue. The SME recognises a refund liability based on the amount of consideration received for goods or services transferred that is not included in the transaction price. As the SME has fulfilled 60% of the promise, it recognises a refund liability of CU7,200 ((CU40,000 – CU28,000) × 60%). The remaining balance of CU16,000 (CU40,000 – CU16,800 – CU7,200) is recognised as a contract liability.

Deferred payment

23.36 If payment is deferred and the arrangement constitutes a financing transaction (see paragraph 11.13B), an entity shall discount the promised amount of consideration at a market rate of interest for a similar debt instrument as determined at the start of the contract. An entity shall recognise the difference between the promised consideration and the discounted value of that amount as interest revenue in accordance with the **effective interest method** (see paragraphs 11.15–11.20).

Educational notes

Determining whether an entity discounts the promised amount of consideration

The description of a financing transaction in paragraph 11.13B determines whether an entity discounts the promised amount of consideration when it determines the transaction price.

An arrangement constitutes a financing transaction if:

- payment is deferred beyond normal business terms; or
- payment is financed at a rate of interest that is not a market rate.

An entity might arrange for a lender (for example, a bank) to provide its customers with financing. In these instances, the entity will typically receive consideration from the lender once the goods or services have been ordered or transferred to the customer. Therefore, despite the customer receiving financing, no discounting is required because the entity did not provide the financing.

Amount discounted

The entity discounts the promised amount of consideration. The promised amount of consideration is the amount of consideration to which an entity expects to be entitled at the start of the contract.

Discount rate used

The requirements in paragraphs 11.13B and 23.36 for determining the discount rate are the same: 'market rate of interest for a similar debt instrument'. Example 3 that follows paragraph 11.13B describes a 'shortcut' for determining this rate—an entity can use the rate that discounts the nominal amount of the promised consideration to the current cash sale price for the goods or services. An entity could apply this shortcut when the current cash sale price for the goods or services in the contract is known.

If an entity applies the shortcut, the resulting interest rate should be assessed for reasonableness. An apparently unusually low rate (taking into account, for example, the time value of money and the credit risk of the buyer) could mean that the current cash sale price has not been properly determined for the customer.

Examples—Deferred payment

Ex 41 An SME sells goods to a customer and charges the customer CU10,000. Payment of the consideration is deferred for two years and the arrangement constitutes a financing transaction. The current cash sale price of the goods is CU8,264.

The SME determines the transaction price by discounting the promised amount of consideration.

The SME determines the discount rate by calculating the rate that discounts the nominal amount of promised consideration (CU10,000) to the current cash sale price of the goods (CU8,264). The rate is calculated at 10% per year. The SME decides this rate is reasonable (taking into account the time value of money and credit worthiness of the customer).

The discounted promised consideration is the current cash sale price of CU8,264. The difference between that amount and the promised consideration is CU1,736. The SME recognises this difference as interest revenue using the effective interest method.

Ex 42 The facts are the same as in Example 41. However, in this example, the SME has no recent transactions from which to make a reliable estimate of the current cash sale price of the goods. The SME estimates that the customer would be able to obtain financing from other lenders at an interest rate of 10% per year.

The SME determines the transaction price by discounting the promised amount of consideration.

The SME uses a discount rate of 10%, which is the market rate of interest for a similar debt instrument as determined at the start of the contract.

The discounted promised consideration is calculated at CU8,264 (CU10,000 ÷ (100% + 10%)^2). The difference between that amount and the promised consideration of CU10,000 is CU1,736. The SME recognises this difference as interest revenue using the effective interest method.

23.37 An entity shall present interest revenue separately from revenue from contracts with customers.

Educational notes

Interest revenue from financing transactions will often be incidental to revenue from contracts with customers. An entity is unlikely to include a separate line item for interest revenue in its income statement to meet the requirement of paragraph 23.37. Instead, an entity is likely to include a line item that comprises interest revenue and other types of income (for example, other income or finance income).

23.38 An entity is permitted not to apply paragraphs 23.36–23.37 if, at the start of a contract, it expects a customer to pay for goods or services within one year of the entity transferring the goods or services.

Educational notes

Paragraph 23.38 gives an entity the option not to account for interest revenue separately.

The option is conditional on a customer paying for goods or services within one year of the entity transferring the goods or services. This is based on the entity's expectations at the start of the contract. The entity's expectations might change during the contract, however the entity is not required to revise its initial expectations.

In accordance with paragraph 23.5, an entity is permitted to apply the option to a portfolio of similar contracts instead of on an individual basis (see Example 6). In such instances, an entity may need to group contracts into different portfolios if the entity does not have the same expectations for when each customer will pay.

Applying the option to some but not all goods or services

In some contracts, the expected time between an entity transferring a good or service and the customer paying for the good or service might not be the same for all goods or services in the contract. Consequently, the entity might be able to apply the option to some but not all goods or services in the contract.

For example, an entity could enter into a contract where payment is due in 18 monthly instalments for both:

- a good transferred at the start of the contract; and
- a service transferred over 18 months.

To determine whether the option applies to the good or service in the contract, an entity would need to allocate:

- the promised amount of consideration to the good and service in the contract; and
- the payments to the good and service.

The entity would then be able to determine whether the good or service is expected to be paid for within one year of being transferred.

The entity would then allocate the discounted promised consideration to the promises in the contract as part of Step 4.

Section 23 does not specify how to apply the option and allocate the promised amount of consideration, payments and discounted promised consideration in such contracts. Consequently, management of the entity would be required, in accordance with paragraph 10.4, to use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable. In doing so, management are required to refer to and consider the applicability of the requirements and guidance in the Standard that deal with similar and related issues (see paragraph 10.5).

Step 4 includes requirements for allocating the transaction price to the promises in a contract, including discounts. Therefore, it would be reasonable for an entity to apply an accounting policy based on the requirements in Step 4.

An entity's accounting policy for such a contract is illustrated in Case study 1, Part B.

Example—Applying the option in paragraph 23.38

Ex 43 An SME sells goods to customers and provides them with a choice to pay on delivery, or in six, 12 or 18 months. If a customer chooses to pay in six, 12 or 18 months, the arrangement constitutes a financing transaction.

For goods sold on six-month or 12-month interest-free credit, the SME expects that customers will pay within one year of the goods being transferred. Therefore, the SME applies the option in paragraph 23.38 and chooses not to account for interest revenue separately for these contracts.

For goods sold on 18-month interest-free credit, the SME expects that customers will not pay within one year of the goods being transferred. Therefore, the SME cannot apply the option in paragraph 23.38 and accounts for interest revenue separately for these contracts.

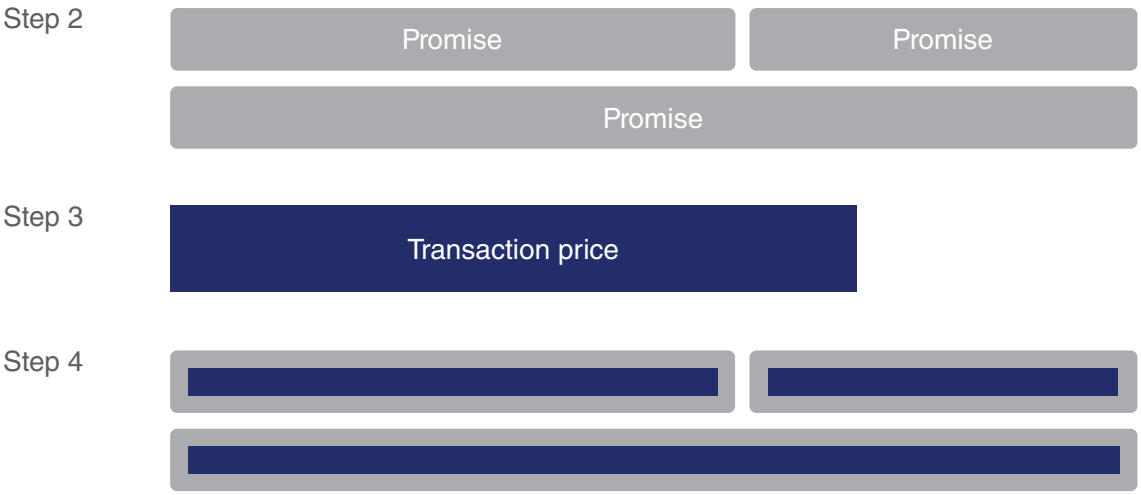
Step 4—Allocate the transaction price to the promises in the contract

Educational notes

The requirements in Step 4 of the revenue recognition model allocates the transaction price determined in Step 3 to the promises identified in Step 2. Therefore, Step 4 brings together the elements from the previous two steps, as shown in Figure 10.

Step 4 is necessary because an entity might fulfil some promises in a contract at different times. Therefore, in Step 5, the entity will recognise the portion of the transaction price allocated to a promise as revenue when (or as) the promise is fulfilled.

Figure 10—Transaction price allocated to promises



23.39 An entity shall allocate the transaction price to each promise it has identified in a contract in accordance with paragraphs 23.40–23.48.

23.40 Step 4 does not apply if an entity fulfils all promises in a contract:

(a) in the same reporting period as the start of the contract; or

(b) at the same point in time in accordance with paragraph 23.58.

23.41 Step 4 does not apply if a contract contains a single promise. However, an entity shall apply paragraph 23.48 if the entity accounts for a series of distinct goods or services as a single promise in accordance with paragraph 23.15 and the transaction price includes an amount of variable consideration.

Educational notes

Paragraphs 23.40–23.41 specify when it is unnecessary for an entity to apply Step 4 of the model.

If the contract contains a single promise or the promises in the contract are fulfilled at the same time, Step 4 is unnecessary. However, an entity is still required to apply Step 4 if the contract contains a single promise that is accounted for as a series and the transaction price includes an amount of variable consideration.

Step 4 is also unnecessary if a contract begins and ends in the same reporting period. For these contracts, the revenue will be recognised in the same reporting period regardless of how it is allocated.

An entity would need to apply Step 5 to determine when the promises in a contract are fulfilled. Therefore, an entity might need to refer to the requirements in Step 5 to determine whether to apply Step 4.

Allocation based on stand-alone selling prices

23.42 At the start of a contract, an entity shall determine the stand-alone selling price of the distinct good or service (or distinct bundle of goods or services) in each promise in the contract. The entity shall allocate the transaction price in proportion to those stand-alone selling prices (that is, on a relative stand-alone selling price basis). The entity shall not reallocate the transaction price to reflect changes in the stand-alone selling prices after the start of the contract.

Educational notes

The transaction price is allocated to each promise in the contract in proportion to the stand-alone selling price of the underlying distinct good or service.

The stand-alone selling prices of goods or services are determined at the start of the contract and not updated. For example, an entity might make subsequent changes to the transaction price because it has updated estimates of variable consideration or because the contract has been modified. Such changes would be allocated to the promises in the contract using the stand-alone selling prices at the start of the contract, not at the date the transaction price changes. The only exception to this is if a contract modification creates a new contract, at which point the stand-alone selling prices would be updated.

Example—Allocation based on stand-alone selling prices

Ex 44 An SME enters into a contract with a customer to sell a product and provide a training course on how to operate the product for CU100.

In accordance with Step 2, the SME concludes that the product and training course are distinct and result in two promises.

In accordance with Step 3, the SME concludes the transaction price is CU100.

In accordance with Step 4, the SME determines the stand-alone selling prices as follows:

Promise	Stand-alone selling price
	CU
Product	90
Training course	30
Total	120

The SME allocates the transaction price of CU100 (including the discount of CU20) proportionately between the product and training course on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Product	75	CU100 × (CU90 ÷ CU120)
Training course	25	CU100 × (CU30 ÷ CU120)
Total	100	

Example—Stand-alone selling prices not updated

Ex 45 **An SME enters into a contract with a customer to transfer two products: Product A in the current reporting period and Product B in the subsequent reporting period. The products are distinct from each other and result in two promises.**

The consideration promised by the customer includes fixed consideration of CU100 and variable consideration. At the start of the contract, the SME includes CU50 of variable consideration in the transaction price. Both products have the same stand-alone selling prices.

At the start of the contract, the SME allocates the transaction price of CU150 (including the variable consideration of CU50) proportionately between the products on a relative stand-alone selling price basis as follows:

Product	Allocated transaction price	Calculation
	CU	
Product A	75	CU150 × (CU75 ÷ CU150)
Product B	75	CU150 × (CU75 ÷ CU150)
Total	150	

When Product A is transferred, the SME recognises revenue of CU75.

At the reporting date, the SME updates the amount of variable consideration included in the transaction price, which changes the transaction price to CU180. The SME allocates the change in the transaction price of CU30 (CU180 – CU150) proportionately between the products using the stand-alone selling prices determined at the start of the contract. Consequently, the SME recognises further revenue of CU15 (CU30 × (CU75 ÷ CU150)) at the reporting date relating to Product A, which has already been transferred to the customer.

23.43 The 'stand-alone selling price' is the price at which an entity would separately sell a good or service. The best evidence of a stand-alone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.

23.44 If a stand-alone selling price is not directly observable, an entity shall estimate that price. An entity shall take into account all information that is reasonably available to it, including market conditions, entity-specific factors and information about the customer or class of customer. An entity shall apply estimation methods consistently in similar circumstances. Suitable estimation methods might include using the entity's competitor's prices for similar goods or services, or the expected costs of the good or service plus an appropriate margin.

Educational notes

If a good or service is sold separately, an entity can observe the selling price by looking at the price charged when the good or service is sold in similar circumstances and to similar customers. If a good or service is not sold separately, the entity is required to estimate the selling price.

Estimating the stand-alone selling price—Factors to consider

Factors an entity takes into account when it estimates the stand-alone selling price of a good or service include:

- *market conditions*—for example, supply and demand for the good or service in the market, competition, restrictions and trends;
- *entity-specific factors*—for example, business pricing strategies and practices; and
- *information about the customer or class of customer*—for example, type of customer, geographical region and distribution channel.

By taking this information into account, the stand-alone selling price of a good or service an entity estimates might change depending on the time, entity and customers involved in a contract.

Estimating the stand-alone selling price—Estimation methods

Paragraph 23.44 does not require entities to apply any specific method to estimate the stand-alone selling price, but includes two suitable methods:

- using a competitor's price; and
- using the expected cost of the good or service and adding a margin.

Another method would be to estimate the stand-alone selling price by reference to the total transaction price minus the sum of the observable stand-alone selling prices of the other goods or services in the contract. The residual amount is deemed to be the stand-alone selling price.

An entity might use a combination of different estimation methods in a single contract.

Example—Determining stand-alone selling prices

Ex 46 **An SME enters into a contract with a customer to supply and fit a medical aid. As part of the same contract, the customer purchases a charger for the aid. The SME does not allow customers to buy medical aids without them being fitted by the SME. Similarly, the SME does not fit medical aids that customers have bought from other entities. The SME regularly sells the charger separately.**

The SME concludes that the sale of the medical aid, charger and fitting service are distinct and result in three promises.

Because the SME regularly sells the charger separately, the stand-alone selling price is directly observable.

Because the stand-alone selling prices for the medical aid and fitting service are not directly observable, the SME estimates them.

The SME estimates the stand-alone selling price for the medical aid based on a competitor's price for a similar product.

The SME estimates the stand-alone selling price for the fitting service based on the expected cost of the service plus a margin.

The stand-alone selling prices are as follows:

Promise	Stand-alone selling price	Method
	CU	
Medical aid	120	Based on competitor's price
Fitting service	25	Expected cost plus margin
Charger	70	Directly observable
Total	215	

23.45 As an exception to paragraph 23.42, an entity might allocate a discount or variable consideration using an alternative method (see paragraphs 23.46–23.48).

Allocation of a discount and variable consideration

23.46 In a contract:

(a) a customer receives a discount if the sum of the stand-alone selling prices of the goods or services promised in the contract is greater than the promised consideration; or

(b) the transaction price might include an amount of variable consideration (see paragraphs 23.26–23.32).

23.47 An entity shall allocate a discount or variable amount to each promise in the contract on a relative stand-alone selling price basis. However, if allocating the discount or variable amount on this basis does not represent the amount of consideration the entity expects to be entitled to in exchange for fulfilling each promise in the contract, the entity shall use another method to allocate the discount or variable amount. For example, the entity might allocate the discount or variable amount to one, or some, of the promises in the contract.

23.48 If an entity accounts for a series of distinct goods or services as a single promise in accordance with paragraph 23.15, it shall allocate a variable amount to each distinct good or service on a relative stand-alone selling price basis. However, if allocating the variable amount on this basis does not represent the amount of consideration the entity expects to be entitled to in exchange for transferring each distinct good or service in the promise, the entity shall use another method to allocate the variable amount. For example, the entity might allocate the variable amount to one, or some, of the distinct goods or services in the promise.

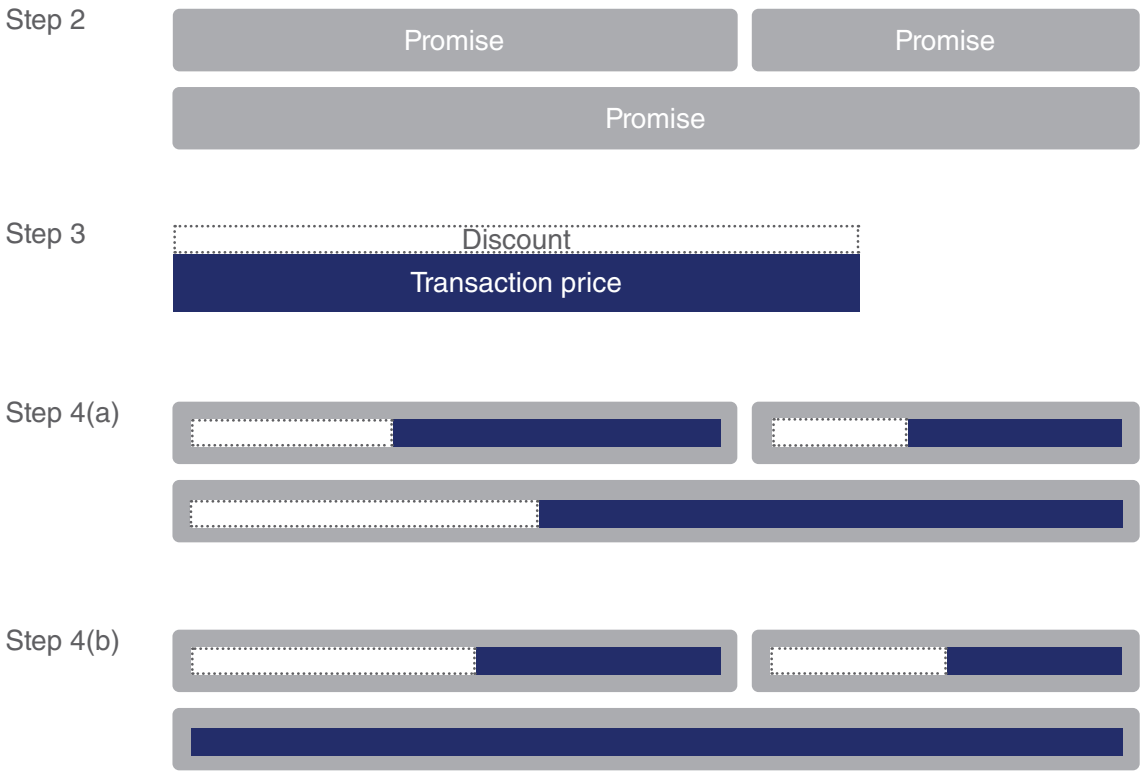
Educational notes

Paragraph 23.47 provides an exception to allocating a discount or variable consideration to each promise in a contract on a relative stand-alone selling price basis. The exception is necessary because allocating the discount or variable consideration in this way might not represent the amount of consideration the entity expects to be entitled to in exchange for fulfilling each promise in the contract.

The exception permits an entity to allocate the discount or variable consideration on a basis other than on a relative stand-alone selling price basis. An entity would be expected to apply the exception in instances in which the discount or variable consideration is specific to one or more (but not all) of the promises in the contract.

Figures 11 and 12 illustrate applying the exception to allocate a discount or variable consideration to each promise in a contract.

Figure 11—Allocation of a discount

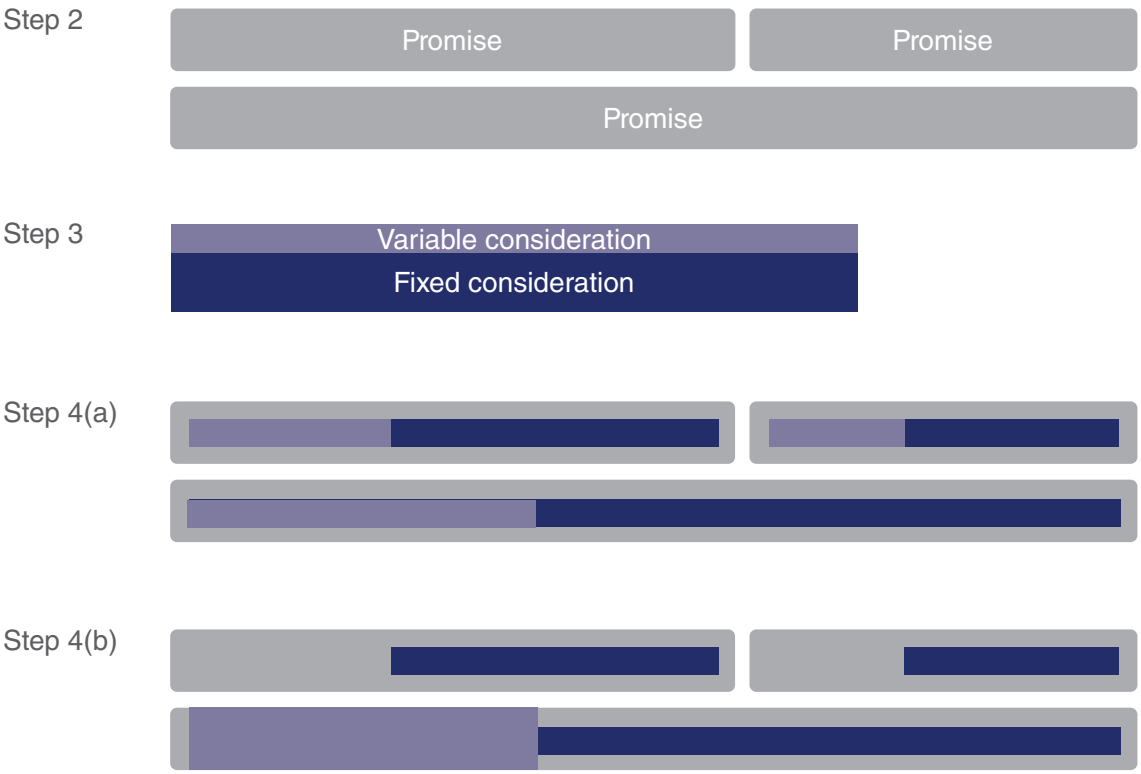


(a) on a relative stand-alone selling price basis—not applying the exception
(b) applying the exception

Allocation of a discount

An entity might award customers a discount if they buy more than one good or service in a contract. These discounts are often attributable to each promise in the contract, so it would be appropriate for the entity to allocate the discount on a relative stand-alone selling price basis. However, the discount might be attributable to one or some (but not all) of the promises in the contract. In such instances, the entity would apply the exception.

Figure 12—Allocation of variable consideration



(a) on a relative stand-alone selling price basis—not applying the exception
(b) applying the exception

Allocation of variable consideration

Whether variable consideration is attributable to each promise in a contract, or only to specific promises, will often be clear from the terms of variable consideration. For example, if the variable consideration relates specifically to the entity's effort in fulfilling a promise, then the variable consideration would be attributable to only that promise. In such instances, the entity would apply the exception.

Application to a series of goods or services accounted for as a single promise

Paragraph 23.48 provides a similar exception to allocating variable consideration to each distinct good or service in a series of goods or services accounted for as a single promise.

The exception allows an entity to allocate the variable consideration to specific goods or services in the series instead of allocating it to all goods or services in the series on a relative stand-alone selling price basis. If the entity does allocate the variable consideration on a relative stand-alone selling price basis, the variable consideration is allocated equally between all the goods or services in the series, because these goods or services would have similar stand-alone selling prices. Allocating the variable consideration on a relative stand-alone selling price basis might result in the entity recognising variable consideration as revenue in a way that does not resemble the amount of revenue to which the entity is entitled. For example, if the variable consideration relates only to some of the goods or services in the contract which were transferred during a specific period of the contract.

If the entity allocates the variable consideration to specific goods or services in the series, it recognises the variable consideration as those goods or service are transferred. Therefore, the exception covers the amount of variable consideration allocated to goods or services in a series and the timing of when that consideration is recognised as revenue. The timing of when fixed consideration is recognised as revenue in a series of goods or services accounted for as a single promise is covered by Step 5.

Example—Allocation of discount based on stand-alone selling prices

Ex 47 An SME enters into a contract with a customer to sell a car and trailer and provide maintenance services.

The SME concludes that the sale of the car, trailer and maintenance services are distinct and result in three promises. The stand-alone selling prices of the car, trailer and maintenance services are directly observable and are as follows:

Promise	Stand-alone selling price
	CU
Car	60
Trailer	40
Maintenance service	30
Total	130

The customer is charged CU104 because the SME has a promotion in which it awards a 20% discount for customers that spend over CU100 in a single transaction.

The customer receives a discount of CU26 because the sum of the stand-alone selling prices (CU130) exceeds the promised consideration (CU104). The discount is attributable to each promise in the contract and allocated on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Car	48	CU104 × (CU60 ÷ CU130)
Trailer	32	CU104 × (CU40 ÷ CU130)
Maintenance service	24	CU104 × (CU30 ÷ CU130)
Total	104	

Example—Allocation of discount using another method

Ex 48 The facts are the same as Example 47. However, in this example, the customer is charged CU100. The SME regularly sells the car and trailer without the maintenance service for CU70.

The customer receives a discount of CU30 because the sum of the stand-alone selling prices (CU130) exceeds the promised consideration (CU100). The amount of consideration the SME would expect to be entitled to in exchange for transferring the car and trailer would be CU70, because the SME regularly sells these goods together for that amount. Therefore, the SME allocates the entire discount to these promises as follows:

Promise	Allocated transaction price	Calculation
	CU	
Car	42	CU70 × (CU60 ÷ CU100)
Trailer	28	CU70 × (CU40 ÷ CU100)
Maintenance service	30	
Total	100	

Example—Allocation of variable consideration based on stand-alone selling prices

Ex 49 **An SME enters into a contract with a customer to license software and install the software onto the customer's computers.**

The software licence and installation services are distinct and their directly observable stand-alone selling prices are as follows:

Promise	Stand-alone selling price
	CU
Software licence	1,650
Installation service	550
Total	2,200

The promised consideration is CU2,200. However, the SME awards customers a 10% early settlement discount if the customer pays within 30 days of the order being placed.

The SME does not expect the customer will be awarded the early settlement discount of CU220 (CU2,200 × 10%) and includes this amount in the transaction price. Therefore, the transaction price comprises:

	CU
Fixed consideration	1,980
Variable consideration	220
Transaction price	2,200

The terms of the early settlement discount relate to customer's ability to pay within 30 days of the order being placed, and not to the SME's effort in transferring a specific good or service. Therefore, the variable amount is attributable to each promise in the contract and allocated on a relative stand-alone selling price basis.

Example—Allocation of variable consideration using another method

Ex 50 The facts are the same as Example 49. However, in this example, the promised consideration is CU2,000 and the SME will also be entitled to a bonus of CU600 if it installs the software onto the customer's computers within six months.

The SME concludes it to be highly probable that it will meet the six-month target and be entitled to the CU600 bonus, and includes the whole amount in the transaction price. Therefore, the transaction price comprises:

	CU
Fixed consideration	2,000
Variable consideration	600
Transaction price	2,600

Because the variable consideration relates to the installation service, the SME allocates the variable consideration of CU600 entirely to the promise to provide the service. The SME allocates the fixed consideration of CU2,000 on a relative stand-alone selling price basis. Allocating the fixed consideration on this basis means the SME would still recognise an amount of revenue for the installation service even if it fails to meet the six-month target and is not entitled to the CU600 bonus.

The transaction price is allocated as follows:

Promise	Allocated transaction price	Calculation
	CU	
Software licence	1,500	CU2,000 × (CU1,650 ÷ CU2,200)
Installation service	1,100	(CU2,000 × (CU550 ÷ CU2,200)) + CU600
Total	2,600	

Examples—Allocation of variable consideration to a series of distinct goods or services

Ex 51 An SME enters into a contract to run an IT help desk five days a week for one year.

The SME charges the customer a fixed upfront fee of CU12,000 at the beginning of the contract, and a monthly charge based on the number of service requests the SME answers. The SME charges CU3 per request.

The service that the SME transfers to the customer is the act of standing ready to provide IT support. Each day of service is distinct.

The SME accounts for the contract as a single promise because the contract is a series of distinct services that are essentially the same and have the same pattern of transfer to the customer.

The transaction price comprises:

	CU
Fixed consideration	12,000
Variable consideration	3 per request

The stand-alone selling price of each day of service is the same. Therefore, allocating the variable consideration on a relative stand-alone selling price basis would mean the amount of variable consideration allocated to each day of service would be the same. Because the consideration varies depending on the number of requests the SME answers, allocating the variable consideration on a relative stand-alone selling price basis would not represent the amount of consideration the SME expects to be entitled to in exchange for each day of service. Instead, the SME allocates the variable consideration to each day of service based on the number of requests it answered that day.

Consequently, the variable consideration of CU3 per request is recognised as revenue as each request is answered.

Ex 52 An SME enters into a contract to provide daily cleaning services for three years.

The SME charges the customer CU10,000 for the first year of service, and agrees that the consideration charged in the second and third years will increase depending on changes in a specified inflation index.

The service that the SME transfers to the customer is cleaning. Each day of service is distinct.

The SME accounts for the contract as a single promise because the contract is a series of distinct services that are essentially the same and have the same pattern of transfer to the customer.

The transaction price comprises:

	CU
Fixed consideration	30,000
Variable consideration	Based on movement in inflation index

The stand-alone selling price of each day of service is the same. Therefore, allocating the variable consideration on a relative stand-alone selling price basis would mean the amount of variable consideration allocated to each year of the contract would be the same. Because the consideration varies depending on the movement in the inflation index in each year, allocating the variable consideration on a relative stand-alone selling price basis would not represent the amount of consideration the SME expects to be entitled to in exchange for each year of service. Instead, the SME allocates the variable consideration to each year of the contract based on the movement in the inflation index in that year.

Consequently, the variable consideration is recognised as revenue in the year to which it relates.

Step 5—Recognise revenue when (or as) the entity fulfils a promise

Educational notes

The requirements in Step 5 of the revenue recognition model determine when the promises identified in Step 2 are fulfilled. When (or as) a promise is fulfilled, the entity recognises as revenue the portion of the transaction price determined in Step 3 that was allocated to the promise in Step 4.

23.49 An entity shall recognise revenue when (or as) it fulfils a promise. An entity fulfils a promise by transferring control of the distinct good or service in the promise to the customer.

Educational notes

The focus of Step 5 is determining when control of the distinct goods or services in a contract transfers to the customer. When control of the distinct goods or services in a promise transfers to the customer, the promise is fulfilled and revenue is recognised. Therefore, the transfer of control, fulfilment of the promise and recognition of the revenue occur simultaneously.

Promises in a contract can be fulfilled at different times. Therefore, an entity is required to apply Step 5 to each promise in a contract.

23.50 Goods and services are **assets**, even if only momentarily, when they are received and used. An entity transfers control of an asset when the customer has the present ability to direct the use of the asset and obtain the economic benefits that might flow from it.

Educational notes

Goods and services are assets

It is relatively clear to see how goods are assets when transferred, however, it is usually not as clear to see how services are assets when transferred. Despite being assets when transferred, services are often not recognised by the entity or customer as assets because they are received and immediately used by the customer.

Components of control

The description in paragraph 23.50 of when an entity transfers control of an asset to a customer is based on three components which the customer must have to control the asset.

- *the present ability*—control can exist only if the customer has the present right to direct the use of the asset and obtain the economic benefits that might flow from the asset. During the contract, it might be clear that the customer will ultimately have this right. However, until the customer obtains that right and has the present ability to use it, control of the asset does not transfer.
- *to direct the use of the asset*—a customer can direct the use of an asset by using the asset itself, allowing another entity to use the asset or restricting another entity from using the asset.
- *to obtain the economic benefits that might flow from the asset*—the economic benefits include potential cash flows (either an increase in cash inflows or decrease in cash outflows). A customer can obtain economic benefits directly or indirectly, such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.

The transfer of control of an asset from an entity to its customer is typically clear at the time it occurs. Therefore, entities are not expected to examine the three components of control when applying Step 5 of the model. However, some features might make it more difficult to determine whether control of an asset has transferred (for example, if the entity enters into a repurchase agreement—see paragraph 23.51).

23.51 When evaluating whether a customer obtains control of an asset, an entity shall consider any agreements to repurchase the asset. The customer does not obtain control of the asset if the entity has a right and obligation to repurchase the asset (a forward) or a right to repurchase the asset (a call option).

Educational notes

Repurchase agreements can affect whether the customer obtains control of an asset. Such agreements might be part of the terms of the contract for the transfer of the good or service, or specified in a separate contract.

Types of repurchase agreements

Paragraph 23.51 refers to two common repurchase agreements:

- a forward, in which the entity has a right and obligation to repurchase the asset; and
- a call option, in which the entity has a right to repurchase the asset.

If a forward or call option exists, the customer does not obtain control of the asset because it is constrained in its ability to direct the use of the asset and obtain the economic benefits that might flow from it (see paragraph 23.50). The customer's ability is constrained because it must return, or be ready to return, the asset to the entity.

An entity's reason for entering into repurchase agreements is typically to obtain finance or to maintain control over its inventory.

When an entity sells a good with a right of return, the entity has an obligation to repurchase the asset at the customer's request but no right to repurchase the asset. Because the entity only has an obligation to repurchase the asset, not a right, the customer obtains control of the asset and the entity recognises revenue in accordance with Section 23.

Subsequent accounting

If a repurchase agreement exists and control of the good or service does not transfer to the customer, no revenue is recognised by an entity applying Section 23. The Standard does not specify how to account for such contracts. Consequently, management of the entity would be required, in accordance with paragraph 10.4, to use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable. In doing so, management is required to refer to and consider the applicability of the requirements and guidance in the Standard that deal with similar and related issues (see paragraph 10.5). For example, Section 11 *Financial Instruments* of the Standard includes requirements for agreements to repurchase financial assets. Repurchase agreements for financial assets are similar to repurchase agreements for non-financial assets.

Paragraph 11.34 requires that if a transfer of a financial asset results in an entity retaining significant risks and rewards of ownership of the transferred asset, the entity is required:

- to retain the asset on its balance sheet; and
- to recognise the consideration received for the asset as a financial liability.

Therefore, it would be reasonable for an entity to apply an accounting policy based on paragraph 11.34. The entity would recognise the consideration received from the customer as a financial liability instead of revenue, similar to a financing transaction.

In developing and applying an accounting policy, the entity may also consider the requirements and guidance in full IFRS Accounting Standards dealing with similar and related issues (see paragraph 10.6). For example, paragraphs B66–B69 of IFRS 15 *Revenue from Contracts with Customers* cover accounting for forward or call options in contracts with customers.

Example—Inventory financing (forward option)

Ex 53 An SME sells 50 units of inventory to a bank for CU800 and simultaneously enters into an agreement to repurchase the inventory from the bank for CU1,000 a year later.

Control of the inventory does not transfer to the bank because the SME has a right and obligation to repurchase the inventory, so the bank is limited in its ability to direct the use of the inventory and obtain the economic benefits that might flow from it. Consequently, the SME does not recognise any revenue in applying Section 23.

Example—Buy back option (call option)

Ex 54 An SME enters into a contract to sell an asset to a customer. The terms of the contract include a clause that gives the SME the right to buy the asset back from the customer within three years.

Control of the asset does not transfer to the customer because the SME has a right to repurchase the asset, so the customer is limited in its ability to direct the use of the asset and obtain the economic benefits that might flow from it. Consequently, the SME does not recognise any revenue in applying Section 23.

23.52 At the start of a contract, an entity shall determine whether it transfers control of the distinct good or service in a promise to a customer either:

(a) over time, in which case the entity fulfils the promise (and recognises revenue) over time in accordance with paragraphs 23.54–23.56; or

(b) at a point in time, in which case the entity fulfils the promise (and recognises revenue) at a point in time in accordance with paragraphs 23.57–23.61.

Educational notes

An entity is required to determine when it fulfils each promise in a contract. When a promise is fulfilled (and when revenue is recognised) is based on when control of the distinct good or service in the promise transfers to the customer.

An entity will fulfil a promise over time or at a point in time. Section 23 requires an entity to first consider whether a promise is fulfilled over time. If a promise is not fulfilled over time, it is fulfilled at a point in time (see paragraph 23.57).

An entity might fulfil different promises in the same contract at different times.

An entity determines at the start of the contract whether it will transfer control of a distinct good or service to a customer over time or at a point in time and is not expected to revisit its decision.

23.53 If a contract with a customer includes a licence that is distinct from the other goods or services in the contract, an entity shall apply paragraphs 23A.28–23A.36 to determine whether the promise to grant the licence is fulfilled over time or at a point in time.

Educational notes

The Appendix to Section 23 includes requirements to determine whether a promise to grant a licence is fulfilled over time or at a point in time. These requirements are different from the requirements in Step 5.

An entity applies the requirements in the Appendix to Section 23 only if the licence is distinct from the other goods or services in the contract (that is, if the entity accounts for the licence as a single promise).

Promises fulfilled over time

23.54 An entity transfers control of a distinct good or service over time, and therefore fulfils a promise over time, if any of these criteria is met:

(a) a customer receives and immediately uses the benefits from the entity's performance as the entity performs (for example, a routine or recurring cleaning service);

(b) a customer controls the asset as the entity makes or improves the asset (for example, a construction contract in which the customer controls the work in progress); or

(c) the asset created by the entity's performance cannot be easily redirected to another customer (see paragraph 23.55) and the original customer is obliged to pay the entity for work done to date (see paragraph 23.56) (for example, a service contract in which an entity provides a professional opinion to a customer that is based on facts and circumstances specific to the customer, and it is obliged to pay the entity for work done to date).

23.55 An asset cannot be easily redirected to another customer if:

(a) the entity would either sell the finished asset to another customer at a significantly lower price than that paid by the original customer, or incur significant costs, compared with the cost of the asset, to rework the finished asset for sale (for example, if an asset was highly customised for a particular customer); or

(b) substantive contractual restrictions prohibit the entity from selling the asset to another customer as that asset is made or improved (for example, if the entity is legally obliged to sell work in progress to the customer).

23.56 A customer might be obliged to pay an entity for work done to date because of specific terms in the contract or laws that apply to that contract. The customer is obliged to pay the entity for work done to date if the entity has either:

(a) a present unconditional right to payment for work done to date; or

(b) an enforceable right to demand or keep payment for work done to date if the contract is cancelled before it is complete for any reason other than the entity's failure to perform as agreed.

Educational notes

The criteria in paragraph 23.54 are based on similar concepts. However, some criteria will be more relevant to certain types of contracts than others.

Customer receives and immediately uses the benefits from the entity's performance as the entity performs (paragraph 23.54(a))

A customer cannot use and obtain benefits from an asset before it controls the asset. If a customer benefits from an entity's performance as the performance occurs, control of the asset must transfer to the customer over time.

This criterion is most applicable to service-type contracts in which the entity's performance is immediately consumed by the customer and no work in progress is created.

It might be difficult in some contracts to determine whether the customer benefits from the entity's performance as the performance occurs. An example is a logistics contract in which the entity is transporting an item from City A to City B. In such a contract, the customer benefits from the entity's performance as the performance occurs because if the goods are transported only part way, another entity would not need to substantially re-perform the entity's performance to date (that is, take the goods back to City A in order to transport them to City B). Consequently, an alternative expression of the criterion is if the entity's work completed to date would not need to be substantially re-performed if another entity were to fulfil the remainder of the promise to the customer.

When considering whether another entity would need to substantially re-perform the work completed to date, an entity:

- disregards potential contractual restrictions or practical limitations that would prevent the entity from transferring the remaining promise to another entity to fulfil; and
- presumes that another entity fulfilling the remainder of the promise would not have the benefit of any asset that is presently controlled by the entity, and the asset would remain controlled by the entity if the promise were to transfer to another entity to fulfil.

Customer controls the asset as the entity makes or improves the asset (paragraph 23.54(b))

If a customer controls the asset that the entity is making or improving, the customer is obtaining the benefit of the entity's performance as it occurs. Therefore, the promise is satisfied over time.

This criterion is most applicable to contracts in which the entity's performance results in work in progress, and the customer clearly controls that work in progress (for example, a construction contract in which the entity is building on the customer's land). The work in progress can be tangible or intangible.

Asset cannot be easily redirected and the customer is obligated to pay for work done to date (paragraph 23.54(c))

This criterion is formed of two parts:

- whether the asset can be easily redirected to another customer; and
- whether the customer is obliged to the pay the entity for work done to date.

This criterion is most applicable to service contracts in which the services are specific to the customer and contracts for the creation of tangible and intangible goods.

Paragraph 23.56 includes criteria that determine whether an entity would have a right to payment for work done to date. The payment would be expected to compensate the entity by covering costs incurred as well as a reasonable profit margin. In most contracts, an entity will only have an unconditional right to payment for work done to date at contract completion or agreed-upon points in the contract, not as work progresses (as described in paragraph 23.56(a)). However, as work progresses, an entity might have an enforceable right to demand or keep payment for work done to date if the contract is cancelled (as described in paragraph 23.56(b)). Therefore, the entity is more likely to have the right described in paragraph 23.56(b) than paragraph 23.56(a).

Examples—Criterion in paragraph 23.54(a) met

Ex 55 An SME enters into a contract to provide building security services. The service is accounted for as a single promise.

The promise is fulfilled over time because the customer receives and immediately uses the benefits of the SME's performance. The benefit is the customer's building being secure. The customer uses this benefit as the SME provides the security services.

Ex 56 An SME enters into a contract to provide grounds maintenance services for an events company. The events company runs festivals that take place on hired sites. For two months before each festival, the SME carries maintenance activities such as cutting grass and watering plants. The maintenance services for each site are accounted for as separate promises.

The promise is fulfilled over time because if the SME were to provide the maintenance services for only one month and the customer hired another entity, the other entity would not need to substantially re-perform the services the SME had already provided.

Example—Criterion in paragraph 23.54(a) not met

Ex 57 An SME enters into a contract to provide a professional opinion based on facts and circumstances specific to the customer. The service is accounted for as a single promise.

The promise does not meet the criterion in paragraph 23.54(a) because if another entity were to fulfil the remainder of the promise to the customer, the SME's work completed to date would need to be substantially re-performed.

The work would need to be substantially re-performed because the professional opinion is unique to the entity providing it and any new entity would not have the benefit of any work done by the SME.

Example—Criterion in paragraph 23.54(b) met

Ex 58 An SME enters into a contract to integrate software into a database. Both the software and database are owned by the customer. The integration service is accounted for as a single promise.

The promise is fulfilled over time because the customer controls the software licence and database during the integration. Consequently, the customer controls the database as the SME improves it.

Example—Criterion in paragraph 23.54(b) not met

Ex 59 An SME enters into a contract to manufacture goods for a customer. The SME controls the raw materials and work in progress. The SME transfers control of the finished goods to the customer when the goods are delivered. The manufacturing of the goods is accounted for as a single promise.

The promise does not meet the criterion in paragraph 23.54(b) because the customer does not control the raw materials or work in progress as the SME manufactures the goods.

Example—Criterion in paragraph 23.54(c) met, asset cannot be easily redirected

Ex 60 An SME enters into a contract to supply 50 units of products to a customer. The customer is a wholesaler and the products will be labelled with the customer's logo. The cost to the SME of labelling the products is small compared with the cost of the products. The products are accounted for as a single promise. The customer is obliged to pay the SME for work done to date.

The promise does not meet the criterion in paragraph 23.54(c) because the products can be easily redirected to another customer.

The product can be easily redirected to another customer because the cost of relabelling the products so they can be sold to another customer would be small compared with the cost of the products.

Example—Criterion in paragraph 23.54(c) not met, asset cannot be easily redirected to another customer

Ex 61 An SME enters into a contract to design a booking system for a customer. The booking system contains features that have been designed specifically for the customer's products. The design of the system is accounted for as a single promise. The customer is obliged to pay the SME for work done to date.

The promise is fulfilled over time because the booking system (in its completed state) cannot be easily redirected to another customer and the customer is obliged to pay the SME for work done to date.

The booking system cannot be easily redirected to another customer because it has been designed specifically for the customer's products. The customer-specific design means the SME would either need to sell the system to another customer at a significantly lower price or incur significant costs to re-work the system for sale.

Ex 62 An SME enters into a contract to develop a new product for a healthcare company. To maintain the company's competitive advantage, the contract includes a clause that restricts the SME from selling the partially developed product, or research related to the product, to another customer. The research is accounted for as a single promise. The customer is obliged to pay the SME for work done to date.

The promise is fulfilled over time because the product cannot be easily redirected to another customer and the customer is obliged to pay the SME for work done to date.

The product cannot be easily redirected to another customer because the contract prohibits the SME from selling the product to another customer as the product is developed.

Examples—Criterion in paragraph 23.54(c) met, customer obliged to pay entity for work done to date

Ex 63 A customer enters into a contract to develop custom software for a customer.

The customer operates in an industry where it is common for customers to cancel development contracts after sharing prototypes of software with other developers who then offer to improve the prototype. To prevent the customer from doing so, the contract specifies that the SME has a right to payment for each hour of development services provided, regardless of future performance.

The development of the software is accounted for as a single promise. The software cannot be easily redirected to another customer.

The promise is fulfilled over time because the software cannot be easily redirected to another customer, and the customer is obliged to pay the SME for the development work it has done to date.

The customer is obliged to pay the SME for the development work it has done to date because the customer has an unconditional right to payment for each hour of development services provided.

Ex 64 **An SME enters into a contract to construct an office. The customer pays a non-refundable deposit at the start of the contract of 30% of the contract price, and progress payments during the contract that equal 20% of the contract price. The remaining 50% is due from the customer once the SME builds the office.**

If the contract ends before the office is built for any reason other than the SME's failure to perform, the SME has a right to demand payment for performance completed to date for its costs plus a 20% margin.

The construction of the office is accounted for as a single promise. The office cannot be easily redirected to another customer.

The promise is fulfilled over time because the office cannot be easily redirected to another customer and the customer is obliged to pay the SME for work done to date.

The customer is obliged to pay the SME for work done to date because if the contract were to end, the SME would use its enforceable right to demand payment for its costs plus a reasonable profit margin.

Example—Criterion in paragraph 23.54(c) not met, customer not obliged to pay entity for work done to date

Ex 65 **The facts are the same as in Example 64. However, in this example, if the customer fails to pay the progress payments when due, the SME only has the right to retain those payments received to date.**

The promise does not meet the criterion in paragraph 23.54(c) because the customer is not obliged to pay the SME for work done to date.

The customer is not obliged to pay the SME for work done to date because if the customer failed to pay the progress payments when due, the SME would only have a right to retain payments received to date. Those payments might not equal the amount of payment the customer is due for work done to date.

Promises fulfilled at a point in time

23.57 If an entity does not transfer control of a distinct good or service over time, the entity transfers control of the good or service at a point in time, and therefore fulfils a promise at a point in time.

23.58 For each promise an entity fulfils at a point in time, the entity shall recognise revenue at the specific point in time a customer obtains control of the distinct good or service. To identify this point in time, an entity shall consider indicators of the transfer of control, which include:

(a) the entity having a present right to payment for the asset;

(b) the customer having legal title to the asset;

(c) the customer having physical possession of the asset;

(d) the customer having the significant risks and rewards of ownership of the asset; and

(e) the customer having accepted the asset (see paragraphs 23.60–23.61).

23.59 The indicators in paragraph 23.58 are not always conclusive. Consequently, the absence of an indicator would not preclude the customer from obtaining control of an asset. If it is clear from other features of the transaction that the customer has the present ability to direct the use of the asset and obtain the economic benefits that might flow from it, the customer has obtained control of the asset.

Educational notes

Identifying the specific point in time a customer obtains control of a distinct good or service will often be straightforward. Entities will often only need to identify this point in time for promises fulfilled close to the reporting date to ensure revenue is recognised in the correct period.

A customer obtains control of a distinct good or service when the entity transfers control of that good or service. This occurs when the customer has the present ability to direct the use of the good or service and obtain the economic benefits that might flow from it (see paragraph 23.50).

The five indicators in paragraph 23.58 are often present when a customer has control of an asset. However, a customer might control an asset in the absence of an indicator (see Examples 66 and 67). Similarly, the presence of an indicator will not always mean that control has been transferred (see Example 68). Therefore, an entity cannot use the five indicators as a checklist.

Example—Absence of indicator (control transferred but customer does not have legal title)

Ex 66 An SME sells a product to a customer on credit. Payment is due within three months of delivery. For all sales on credit, the contract includes a clause that legal title passes to the customer only when consideration is received and not when the product is delivered to the customer.

When a product is delivered to the customer, all indicators of the transfer of control in paragraph 23.58 are present other than the customer having legal title to the product. The SME retains legal title to the asset for the purpose of protecting it against the customer's failure to pay.

However, despite the customer not having legal title, it has the present ability to direct the use of the product and obtain the economic benefits that might flow from the product. Therefore, control of the product transfers to the customer on delivery.

Example—Absence of indicator (control transferred but customer does not have physical possession)

Ex 67 An SME manufactures doors for a customer. The doors are for an office that the customer is building that is six months behind schedule. As a result of the delay to the schedule, the customer asks the SME to delay delivery of the doors by six months.

While the doors are at the SME's premises, they must be ready for delivery to the customer. Consequently, the SME does not have the ability to use the doors or direct them to another customer and obtain the economic benefits that might flow from them. Although the doors remain in the SME's physical possession, it is the customer that controls the doors during this time, not the SME. Therefore, the SME recognises revenue before it delivers the doors to the customer.

Example—Presence of indicator (control not transferred but customer has physical possession)

Ex 68 An SME manufactures items of furniture that it sells to customers both directly and through a dealer. Items of furniture are displayed in the dealer's showroom, however the dealer only pays the SME consideration for items the dealer sells. The SME can request for the dealer to return items so they can be sold directly to customers of the SME or transferred to other dealers.

When an item of furniture is delivered to the dealer, the dealer physically possesses the item. However, because the SME can request for the item to be returned and sold to other customers, the SME still has the present ability to direct the use of the item and obtain the economic benefits that might flow from them. Therefore, the SME would not recognise any revenue at that point because it still controls the item.

When the dealer sells the item, the SME has a present right to payment for the item and no longer controls it. Therefore, the SME would recognise revenue at this specific point in time.

Customer acceptance

23.60 Customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action if a good or service does not meet agreed-upon specifications.

23.61 If a contract includes a customer acceptance clause and the entity cannot identify whether a good or service meets the agreed-upon specifications based on the information available to the entity, it shall wait until it receives the customer's acceptance before it concludes that the customer has obtained control of the good or service.

Educational notes

Interaction with the indicators of the transfer of control

A customer having accepted an asset is an indicator that control of the asset has transferred (see paragraph 23.58(d)). In accordance with paragraph 23.59, the absence of this indicator would not preclude control being transferred. However, an entity might be unable to identify whether a good or service meets the agreed-upon specifications in a customer acceptance clause based on information available to it. In such instances, the entity is unable to conclude that control has been transferred until it receives the customer's acceptance, in accordance with paragraph 23.61.

Nature of agreed-upon specifications

If an entity can identify whether a good or service meets the agreed-upon specifications based on information available to it, then customer acceptance does not affect when control of a good or service transfers to a customer. For example, if the entity can check before it delivers a good or service to the customer that the agreed-upon specifications are met (for instance, the product is the agreed-upon size or weight), customer acceptance is only a formality. However, the agreed-upon specifications might relate to information that is specific to the customer and not available to the entity. Therefore, the entity would have to wait until it receives the customer's acceptance before it concludes that the customer has obtained control of the good or service.

Example—Can identify good or service meets agreed-upon specifications

Ex 69 An SME manufactures items of machinery. All contracts to manufacture machinery include a customer acceptance clause. The clause allows customers to test the machinery and requires the SME to repair it if it does not meet the agreed-upon specifications. The SME tests each item of machinery against the agreed-upon specifications before delivery.

The SME would expect the machinery to meet the agreed-upon specifications when tested by the customer if the machinery met the specification before delivery. Therefore, the SME can identify that the machinery will meet the agreed-upon specifications before it receives the customer's acceptance based on the information available to it. Customer acceptance does not affect when control of the machinery transfers to a customer.

Example—Cannot identify good or service meets agreed-upon specifications

Ex 70 The facts are the same as in Example 69. However, in this example, the agreed-upon specifications include functionality with the customer's existing manufacturing process.

The SME will not know whether the machinery will function with the customer's existing manufacturing process until the customer receives and tests the machinery. Therefore, the SME cannot use the information available to it to identify whether the machinery will meet the agreed-upon specifications before it receives the customer's acceptance. Until the SME receives the customer's acceptance, the SME cannot conclude that the customer has obtained control of the machinery.

Measuring progress towards fulfilment of a promise

23.62 For each promise fulfilled over time in accordance with paragraphs 23.54–23.56, an entity shall calculate how much revenue to recognise in each reporting period by measuring its progress towards fulfilment of that promise at the end of the period.

23.63 An entity shall choose a method of measuring progress that depicts the entity's performance in transferring control of goods or services promised to the customer. An entity shall apply one method of measuring progress for each promise fulfilled over time and shall apply that method consistently to similar promises and in similar circumstances.

23.64 At the end of each reporting period, an entity shall remeasure its progress towards fulfilment of a promise to reflect any changes in circumstances. The entity shall account for changes to the measure of progress as a change in **accounting estimate** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

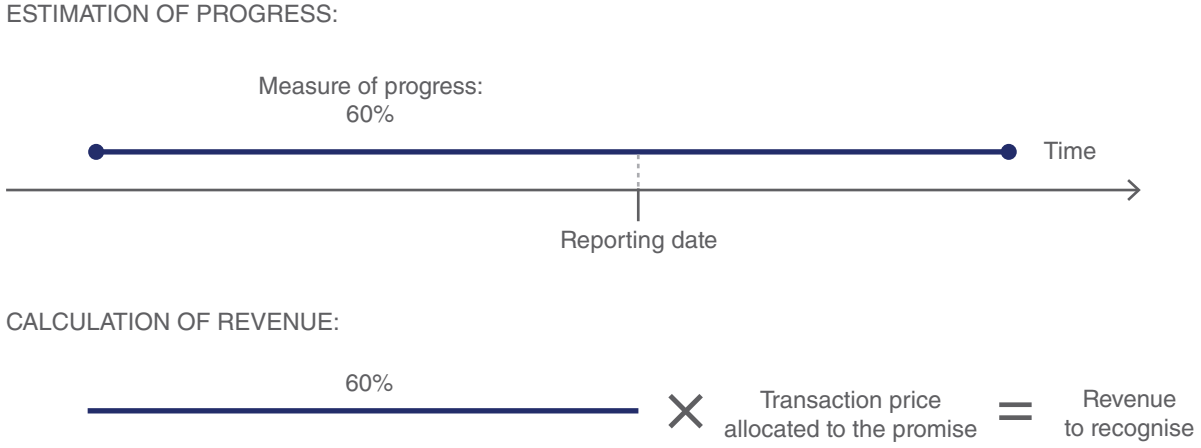
Educational notes

Calculating how much revenue to recognise

If a promise is fulfilled at a point in time, an entity recognises all of the transaction price allocated to that promise as revenue at that point in time. By contrast, if a promise is fulfilled over time, an entity recognises the transaction price allocated to that promise as revenue based on the entity's progress in fulfilling the promise.

When the fulfilment of a promise spans more than one reporting period, an entity is required to estimate its progress in fulfilling the promise at each reporting date. The entity's progress is based on the transfer of control of goods or services promised to the customer. Figure 13 shows the estimate and calculation required for such promises.

Figure 13—Calculation of how much revenue to recognise



Methods of measuring progress

Paragraphs 23.65–23.66 describe the different methods an entity might use to measure progress in fulfilling a promise.

An entity cannot apply different methods to measure progress for the same or similar promises.

Interaction with Section 10 Accounting Policies, Estimates and Errors

The amount of revenue recognised from promises fulfilled over time cannot be observed directly and must instead be estimated. Because the amount is estimated, measurement uncertainty arises. Amounts in the financial statements that are subject to measurement uncertainty are accounting estimates.

An entity estimates the amount of revenue recognised from promises fulfilled over time by estimating its progress towards fulfilling such promises. The entity estimates its progress by choosing a method that depicts its performance in transferring control of goods or services to the customer. The entity applies the method by estimating the total inputs (or total outputs) and comparing it with the inputs (or outputs) at the reporting date—for example, total expected costs compared to costs incurred to date, as explained in paragraph 23.65.

Accounting for changes in accounting estimates

Section 10 requires an entity to account for changes in accounting estimates prospectively (see paragraphs 10.16–10.17).

An entity's estimate of total inputs or outputs used to estimate the amount of revenue recognised from promises fulfilled over time might change as a contract progresses. Similarly, the total inputs or outputs will become known when the promise is fulfilled. When these estimates are updated, an entity does not revisit its measures of progress at previous reporting dates. Instead, the entity adjusts the revenue by recognising the effect of the change in the period the estimate is updated, meaning that it accounts for the change prospectively.

Disclosing changes in accounting estimates

Section 10 requires an entity to disclose information about changes in accounting estimates (see paragraph 10.18).

No disclosure is necessary for promises spanning only two reporting periods because the estimate is not remeasured at a future reporting date and the accounting estimate does not change between reporting dates.

Disclosure is necessary for promises spanning more than two reporting periods if the total expected inputs or outputs used to make the estimate are re-estimated (for example, if total expected costs are re-estimated). However, no disclosure is necessary for such promises if the total expected inputs or outputs remain unchanged and only the inputs or outputs at the reporting dates are updated (for example, if costs incurred to date are updated). In such instances, any change to the amount of revenue recognised is a consequence of the entity's progress and not because the estimate of the total inputs or outputs has changed.

Example—Measuring progress towards fulfilment of a promise

Ex 71 **An SME has a contract to build a house for CU2,000. It will take 20 months to construct the house.**

The building of the house is accounted for as a single promise fulfilled over time. The SME concludes the transaction price is CU2,000.

The contract spans three reporting periods, as shown in Figure 14.

Figure 14—Contract timeline

The SME remeasures its progress towards fulfilling the promise to build the house at the end of Year 1 and Year 2.

The SME measures its progress based on costs incurred.

Six months into the contract, at the end of Year 1:

- Total expected costs to fulfil the promise = CU1,000
- Costs incurred by the end of Year 1 = CU200
- Measure of progress = CU200 ÷ CU1,000 = 20%
- Revenue recognised in Year 1 = 20% × CU2,000 = CU400

Eighteen months into the contract, at the end of Year 2:

- Total expected costs to fulfil the promise = CU1,500
- Costs incurred by the end of Year 2 = CU1,200
- Measure of progress = CU1,200 ÷ CU1,500 = 80%
- Revenue recognised in Year 2 = (80% × CU2,000) – CU400 = CU1,200

The total expected costs to fulfil the promise were estimated at CU1,000 at the end of Year 1. The SME re-estimated this amount as CU1,500 at the end of Year 2.

At the end of Year 2, the SME does not revisit the measure of progress used to estimate the amount of revenue recognised in Year 1 for this re-estimation (see paragraph 10.16). Instead, the effect of re-estimation is recognised in Year 2 by recalculating the measure of progress.

The SME would disclose the change to the measure of progress as a consequence of this re-estimation as a change in accounting estimate (see paragraph 10.18). The disclosure is necessary because the total costs used to estimate the amount of revenue has changed.

23.65 When choosing which method to use to measure its progress, an entity shall consider the nature of the good or service it will transfer to a customer. Appropriate methods of measuring progress include methods that recognise revenue based on:

(a) the value to the customer of the goods or services transferred to date relative to the remaining goods or services to be transferred under the contract ('output methods'); and

(b) the entity's efforts or inputs to fulfil a promise relative to the total expected inputs to fulfil the promise ('input methods').

23.66 Common methods, and circumstances in which they might be appropriate, include:

(a) an output method based on surveys of completed work, if the surveys give an objective measure of an entity's performance to date;

(b) an output method based on units delivered, if each item transfers an equal amount of value to the customer on delivery;

(c) an output method based on time elapsed, if control of the goods or services is transferred evenly over time;

(d) an input method based on time elapsed, if an entity's efforts or inputs are spent evenly throughout the performance period;

(e) an input method based on labour hours spent, if the labour hours spent and the transfer of control of goods or services to the customer are related; and

(f) an input method based on costs incurred, excluding costs that do not contribute, or are not proportionate, to the entity's progress towards fulfilment of the promise (for example, inefficiencies and wasted or uninstalled materials).

Educational notes

Choosing a method of measuring progress—Balancing costs and accuracy

An entity does not have a free choice when choosing a method to measure progress. The method is required to depict the entity's performance in transferring control of goods or services promised to the customer.

The chosen method should measure the entity's progress in a way that represents its progress. The measure is not required to replicate the entity's progress because of the excessive costs that it would need to incur to do so. Instead, the entity should aim for a reasonable measure of progress.

Paragraph 23.65 describes two types of methods:

- output methods, which aim to depict an entity's performance by measuring the value to the customer of the goods or services transferred by the entity to date. Because the value to the customer of the goods or services transferred is often not directly observable, obtaining reliable information to apply output methods can be complex and costly. For example, to apply an output method, an entity might have to survey its performance completed or appraise its results achieved to date.
- input methods, which indirectly measure the value to the customer of the goods or services transferred by measuring the entity's efforts or inputs to date. Input methods use inputs as a proxy for value to the customer. Because inputs are often directly observable, it will often be easier and less costly to obtain reliable information to apply input methods than output methods.

Paragraph 23.66 lists three common output methods and three common input methods. The list is not exhaustive. An entity might use a different method, or a hybrid of methods, to depict its performance in transferring control of goods or services promised to the customer.

Choosing a method of measuring progress—Nature of goods or services transferred

An entity is required to consider the nature of the goods or services it will transfer to a customer when choosing a method of measuring progress. The nature of the good or service is determined by the distinct good or service underlying the promise. The method the entity chooses is required to depict the entity's performance in transferring that distinct good or service to the customer.

For example, in a typical gym contract, an entity's promise is to make the gym available to the customer throughout the contract, standing ready to provide access to the gym. The entity performs by making the gym available throughout the contract, regardless of whether the customer uses it. The method that the entity chooses to measure progress is required to reflect the nature of the service and depict its performance in making the gym available throughout the contract. In this example, the entity might conclude that the value to the customer of having access to the gym during the contract is transferred evenly during the contract and might therefore use a time-based measure of progress (see paragraph 23.66(c)).

Applying output methods—Work in progress

For promises fulfilled over time, the customer controls the work in progress (WIP) as it is produced. If an entity measures progress based on the number of goods it finishes or delivers (see paragraph 23.66(b)), the entity would ignore any WIP. However, by ignoring the WIP, the entity's measure of progress would be understated because the customer controls the WIP. Therefore, if the WIP is material, then an entity should take it into account when measuring progress.

Applying input methods—Inefficiencies and wasted materials

If measuring progress based on costs incurred, an entity might need to adjust the measure by excluding some costs so it accurately represents the entity's performance (see paragraph 23.66(f)). Costs are excluded if they do not contribute or are not proportionate to the entity's progress.

Examples of costs that do not contribute to the entity's progress are those arising from inefficiencies and wasted materials. These costs do not contribute to the entity's progress because no value transfers to the customer if a task is incorrectly performed, or if staff time or materials are wasted. Therefore, an entity should exclude from its measure of progress costs arising from inefficiencies and wasted materials that are not reflected in the price of the contract. Paragraph 23.66 requires an entity to exclude such costs if the entity is using an input method based on costs incurred. An entity would be expected to make a similar adjustment to an input method based on labour hours spent (see Example 75).

Applying input methods—Uninstalled materials

Another example of costs that are not proportionate to the entity's progress is the cost of purchasing materials that the entity will then install or use as part of fulfilling the promise (for example, materials in a construction contract).

If a customer *does not* obtain control of the materials until they are installed or used, the value that transfers to the customer when the materials are bought is minimal compared with the value that transfers when the materials are then used or installed. To depict the entity's performance in transferring control of the goods or services promised to the customer, the entity should exclude the cost of such materials from its measure of progress and recognise revenue when materials are installed or used, instead of when the materials are bought.

If a customer *does* obtain control of the materials before they are installed or used, some value transfers to the customer when the materials are bought. Although the cost of the materials is not proportionate to the entity's progress, the entity should recognise some revenue when these costs are incurred in order to depict its performance in transferring control of the materials to the customer. One way to do this would be to exclude the cost of the materials from both the entity's measure of progress and the transaction price. The entity would recognise revenue for the materials as they are bought at an amount equal to their cost (see Example 76).

Applying input and output methods—Recognising revenue on a straight-line basis over the contract

Paragraph 23.66(c)–(d) specifies that a time-based method of measuring progress is likely to be appropriate if:

- control of the goods or services is transferred evenly over time; or
- an entity's efforts or inputs are spent evenly throughout the performance period.

Consequently, an entity would be expected to recognise revenue on a straight-line basis over the contract if there is some regularity in the control transferred to the customer, or the effort or input spent by the entity, throughout the performance period. If not, the entity would be expected to use a different pattern of revenue recognition.

Example—Choosing a reasonable measure of progress

Ex 72 An SME installs kitchens for customers. The installation of a kitchen is accounted for as a single promise fulfilled over time.

The SME's reporting date is during a traditional holiday season. Because of the timing of the SME's reporting date, most of its contracts with customers are complete before the end of the reporting period and few contracts span the reporting date.

When choosing a method to measure its progress towards fulfilling promises to install kitchens, the SME considers applying an output method based on surveys of completed work. However, such surveys would need to be performed at a time most people are on holiday and by an independent inspector to give an objective measure of the SME's performance. Consequently, the costs of performing a survey at the reporting date would be high because the SME would need to engage an inspector when few are available.

Because of the costs associated with the surveys and the number of contracts that span the reporting date, the SME decides that an input method based on costs incurred would give a reasonable proxy for value to the customer and would be less costly than an output method based on surveys of completed work. Consequently, the SME applies an input method based on costs incurred.

Example—Choosing a method of measuring progress based on nature of goods or services transferred

Ex 73 An SME has a contract to design and manufacture 10 prototypes of a product. The design and manufacture of the products is accounted for as a single promise fulfilled over time.

When choosing what method to use to measure its progress towards fulfilling the promise, the SME considers the nature of the goods and services it will transfer. The SME's promise is to design and manufacture products: the SME performs by designing and then manufacturing the products.

The SME considers applying an output method based on products manufactured. However, the SME decides that this method neither reflects the nature of the goods and services (designing and manufacturing), nor depicts its performance in transferring these goods and services. This is because the method only depicts the SME's performance in manufacturing the products and understates the SME's progress in designing them.

The SME decides that an input method based on labour hours spent gives a reasonable proxy for value to the customer and more accurately represents the SME's performance in designing and manufacturing the products than an output method based on products manufactured. Consequently, the SME applies an input method based on labour hours spent.

Example—Applying output methods (work in progress)

Ex 74 **An SME enters into a contract to manufacture six units of specialised machinery for a customer for CU2,400. The manufacture of the six units of machinery is accounted for as a single promise fulfilled over time.**

The SME uses an output method based on units produced to measure its progress towards fulfilling the promise.

At the end of Year 1, the SME has finished manufacturing two of the units and has begun manufacturing the remaining four units. The remaining four units are approximately 40% complete.

Measuring progress based on the two units produced would ignore the work in progress on the four units and understate revenue. Consequently, the SME takes the work in progress into account when measuring progress as follows:

Completion status	Number of units	Percentage complete at end of Year 1	Measure of progress in units
Finished	2	100%	2.0
Work in progress	4	40%	1.6
Total	6		3.6

Measure of progress = 3.6 ÷ 6 = 60%

Revenue recognised in Year 1 = 60% × CU2,400 = CU1,440

Example—Applying output methods (inefficiencies and wasted materials)

Ex 75 **An SME enters into a contract to integrate software into a database for CU5,000. Both the software and database are owned by the customer. The integration service is accounted for as a single promise fulfilled over time.**

The SME uses an input method based on labour hours spent to measure its progress towards fulfilling the promise. The SME expects it will take 80 hours to fulfil the promise.

At the end Year 1, the SME has spent 50 hours fulfilling the promise. However, 10 of the 50 hours were spent fixing a bug caused by a programming error made by the SME while integrating the software. The occurrence of the bug was not reflected in the price of the contract.

Including the hours spent on fixing the bug would overstate the extent of the SME's progress towards fulfilling the promise. Consequently, the hours are excluded when measuring progress as follows:

Expected hours		80
Hours spent in Year 1	50	
Minus hours spent on error	(10)	
Hours spent in Year 1 (excluding hours spent on error)		40

Measure of progress = 40 ÷ 80 = 50%

Revenue recognised in Year 1 = 50% × CU5,000 = CU2,500

Example—Applying output methods (uninstalled materials)

Ex 76 An SME has a contract to refurbish a kitchen for CU26,000. The refurbishment service is accounted for as a single promise fulfilled over time.

The SME uses an input method based on costs incurred to measure its progress towards fulfilling the promise. The expected cost of the refurbishment is CU20,000, which includes CU6,000 for appliances the SME will install. At the end of Year 1, the SME has incurred costs of CU18,000, which includes CU4,000 spent on purchasing appliances. The appliances were delivered to the site in Year 1 and will be installed in Year 2.

Including the costs incurred to purchase the appliances would overstate the extent of the SME's progress towards fulfilling the promise. Consequently, these costs are excluded when measuring progress at the end of Year 1 as follows:

	CU	CU
Expected costs		20,000
Costs incurred in Year 1	18,000	
Minus cost of appliances	(4,000)	
Costs incurred in Year 1 (excluding cost of appliances)		14,000

Measure of progress = CU14,000 ÷ CU20,000 = 70%

The SME obtains control of the appliances when they are delivered to the site. Therefore, the SME recognises revenue for the appliances by excluding their cost from the transaction price and recognising revenue at an amount equal to their cost.

Revenue recognised in Year 1 = (70% × (CU26,000 – CU4,000)) + CU4,000 = CU19,400

23.67 If an entity has a right to consideration from the customer in an amount that relates directly to the value to the customer of the entity's work to date (for example, a service contract in which an entity bills a fixed amount for each hour of service provided), the entity is permitted to recognise revenue in the amount it has a right to invoice.

Educational notes

Relief provided by recognising revenue based on right to invoice

If an entity recognises revenue based on the amount of consideration it has a right to invoice, the entity is not required:

- to determine the transaction price (Step 3);
- to allocate the transaction price to the promises in the contract (Step 4); or
- to measure progress towards fulfilling the promises.

This relief is typically applicable to entities that enter into contracts to provide services for an unknown quantity of units at an agreed rate (for example, CU50 per unit of service).

Value to the customer

To recognise revenue based on the amount of consideration it has a right to invoice, an entity compares:

- the amount of consideration it has a right to invoice; and
- the value to the customer of its work to date.

To estimate the value to the customer of its work to date, the entity could look to the market prices or stand-alone selling prices of the goods or services transferred.

Right to invoice

The amount of consideration an entity has a right to invoice and the amount of consideration it has invoiced and recognised on its sales ledger might not be the same. Therefore, an entity might need to recognise additional revenue at the reporting date for any unbilled work to which it has a right to invoice at the reporting date.

Example—Recognition of revenue based on right to invoice

Ex 77 An SME provides drilling services to a customer in the extractives industry over a 12-month period. Regardless of whether new minerals are located, the SME has a right to invoice the customer for the time spent drilling. The customer pays an hourly rate of CU100. The rate is priced based on the market price of drilling services in the industry. In the current reporting period, the SME spent 150 hours drilling.

The SME has a right to consideration from the customer in an amount that relates directly to the value of the SME's work completed to date. Consequently, the SME recognises revenue equal to the amount of consideration that it has a right to invoice, that is, CU15,000 (CU100 × 150 hours).

Contract costs

Educational notes

Section 23 mainly covers accounting for revenue from contracts with customers. However, it also includes requirements for the costs associated with such contracts. The requirements cover:

- costs to obtain a contract (see paragraph 23.68); and
- costs to fulfil a contract (see paragraphs 23.69–23.76).

Costs to obtain a contract

23.68 An entity shall recognise the costs of obtaining a contract with a customer as an **expense** when incurred, unless another section of this Standard requires the costs to be recognised as part of the cost of an asset.

Educational notes

The amount of effort and resources to obtain contracts with customers varies between entities in different industries. Examples of costs to obtain a contract are:

- staff time spent on delivering a proposal for a contract;
- costs of customer due diligence; and
- commission paid to sales employees.

Section 23 does not require an entity to separately recognise or disclose costs to obtain a contract. Consequently, unless another section of the Standard requires the costs to be recognised as part of the cost of an asset, an entity would not need to separately identify these costs.

Examples of costs to obtain a contract that might be required to be recognised as part of the cost of an asset by another section of the Standard would be expenditure incurred on:

- property, plant or equipment; or
- intangible assets used to deliver a contract proposal.

An entity would determine whether to recognise such costs as assets in accordance with Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill.*

Example—Costs to obtain a contract

Ex 78 An SME obtains a contract with a new customer. The SME incurred CU100 to deliver a proposal to obtain the contract.

The SME recognises the CU100 on delivering the proposal as an expense when incurred.

Costs to fulfil a contract

23.69 An entity shall account for the costs incurred to fulfil a contract with a customer in accordance with the relevant section of this Standard for those costs (for example, Section 13 *Inventories*, Section 17 *Property, Plant and Equipment* or Section 18 *Intangible Assets other than Goodwill*).

23.70 If the costs incurred to fulfil a contract are not within the scope of another section of this Standard, an entity shall recognise those costs as an asset if:

(a) the costs relate directly to a contract (including future contracts) that the entity can specifically identify (for example, costs relating to a specific contract that has not yet been approved) (see paragraph 23.71);

(b) the costs create or improve the entity's resources that it will use to fulfil (or continue to fulfil) promises in the future; and

(c) the entity expects to recover the costs.

23.71 Costs that relate directly to a contract include direct labour, direct materials and allocations of costs that relate directly to the contract or contract activities.

23.72 General and administrative costs do not normally satisfy the criteria in paragraph 23.70 and are therefore recognised as expenses when incurred.

23.73 An entity shall recognise costs that relate to promises that are fulfilled (or partially fulfilled) as expenses when incurred, because those costs relate to past performance.

Educational notes

Costs to which the criteria apply

Paragraphs 23.69–23.70 require an entity to account for costs incurred to fulfil a contract by applying any specific requirements in the Standard covering those costs. The Standard includes requirements that cover many costs an entity might incur when fulfilling a contract. Consequently, an entity is generally not expected to apply the criteria in paragraph 23.70, unless it is a service provider.

Typically, the largest cost for service providers is staff costs. Section 28 *Employee Benefits* covers staff costs and requires such costs to be recognised as an asset if required by another section of the Standard (see paragraph 28.3(b)). Other relevant sections of the Standard include Section 13 *Inventories* and Section 18 *Intangible Assets other than Goodwill*. However:

- Section 13 covers the cost of inventories for entities that supply goods, not services; and
- Section 18 excludes intangible assets held for sale in the ordinary course of business (for example, work in progress) (see paragraph 18.1).

Therefore, a service provider would be expected to recognise the costs of fulfilling a contract that meet the criteria in paragraph 23.70 as an asset, unless there are more specific requirements in the Standard covering such costs.

Costs relate directly to a contract that the entity can specifically identify (paragraph 23.70(a))

The criterion in paragraph 23.70(a) refers to costs that relate directly to current and future contracts. The reference to future contracts means it is not necessary for a contract to be approved or have begun before an entity recognises the costs incurred to fulfil the contract as an asset. For example, an entity would recognise pre-production costs as an asset if they meet the criteria in paragraph 23.70.

Costs create or improve the entity's resources that it will use to fulfil promises in the future (paragraph 23.70(b))

The criterion in paragraph 23.70(b) refers to costs that will be used to fulfil promises in the future. The criterion links with paragraph 23.73, which requires entities to recognise costs that relate to promises that have already been fulfilled or partially fulfilled as expenses when incurred. Therefore, it can be helpful for an entity to consider the requirements together as summarised in Table 2.

Table 2—Relationship between the treatment of costs and fulfilment of promises

Costs relate to	Treatment
Fulfilled promises	Recognise as an expense
Not yet fulfilled promises	Recognise as an asset if costs meet the criteria in paragraph 23.70
Partially fulfilled promises (promises fulfilled over time)	Recognise as an expense if costs relate to past performance
	Recognised as an asset if costs relate to future performance and criteria in paragraph 23.70 are met

For example, for a promise to construct a building fulfilled over time:

- if the construction has yet to start (promise is not yet fulfilled), pre-production costs are recognised as an asset if they meet the criteria in paragraph 23.70.
- if the construction has started (promise is partially fulfilled), costs that relate to construction work that has been performed are recognised as an expense.

For promises fulfilled over time, the customer controls the work in progress as it is produced. Costs incurred by an entity to fulfil such promises will often create or improve the work in progress that is controlled by the customer, not the entity. Therefore, an entity is generally expected to recognise costs incurred after it has started fulfilling these promises as an expense, because such costs create or improve the customer's resources.

Entity expects to recover the costs (paragraph 23.70(c))

The criterion in paragraph 23.70(c) refers to costs expected to be recovered. Costs are classified as recoverable if they are explicitly chargeable or expected to be recovered through sale proceeds.

General and administrative costs

General and administrative costs would not usually meet the criteria in paragraph 23.70 to be recognised as an asset. However, if the costs are explicitly chargeable to the customer, the costs relate directly to the contract and would be expected to be recovered. Therefore, the costs would meet the criteria in paragraphs 23.70(a) and (c). Consequently, general and administrative costs that are explicitly chargeable to the customer would be recognised as an asset if they also meet the criterion in paragraph 23.70(b).

Example—Costs to fulfil a contract (identifying costs to which the criteria apply)

Ex 79 An SME enters into a contract to provide a professional opinion to a customer.

The professional opinion is about an industry with which the SME is unfamiliar. The SME assigns an employee to work on the contract. Before the contract starts, the employee:

- **undertakes research into the industry; and**
- **completes a training course to learn about the industry.**

By the end of Year 1, the contract has started and the employee has begun working on the professional opinion.

The time spent on the contract by the employee in Year 1 is as follows:

Activity	Time spent (number of hours)
Researching the industry	25
Completing a training course	10
Working on the professional opinion	65
Total	100

The employee uses the SME's equipment. The costs of equipment used by employees is allocated to specific contracts based on staff time.

The SME accounts for the service as a single promise fulfilled at a point in time.

The costs of employee's time spent on the contract and the allocation of equipment costs are costs incurred as part of fulfilling the contract.

Staff costs

Section 28 covers staff costs and requires such costs to be recognised as an asset if required by another section of the Standard. Which sections of the Standard are relevant differ based on the activity the employee undertakes.

Staff costs—Researching the industry and completing a training course

The employee undertakes research and training activities before they begin work on providing the professional opinion. Therefore, the costs of the employee's time spent on research and training are not considered to be expenditure on intangible assets held for sale in the ordinary course of business (see paragraph 18.1). Therefore, the expenditure is in scope of Section 18.

Section 18 includes requirements for expenditure on internally generated intangible assets, including research and training activities. Paragraph 18.14 requires expenditure on internally generated intangible assets to be recognised as an expense as it is incurred, unless it forms part of the costs of another asset that meets the recognition criteria in the Standard.

The employee, not the SME, holds the knowledge gained from the research and training activities. Although the SME expects the employee will continue to work on the contract, it does not control the employee. Therefore, the employee's knowledge is not a resource of the SME's that it will use to provide the professional opinion in Year 2. The SME concludes that the criteria in paragraph 23.70 are not met, and the SME recognises the staff costs on research and training as an expense as incurred.

Staff costs—Working on the professional opinion

The staff costs of working on the professional opinion are not covered by another section of the Standard because:

- Section 13 covers the cost of inventories for entities that supply goods, not services; and
- Section 18 excludes intangible assets held for sale in the ordinary course of business.

Therefore, the costs are assessed against the criteria in paragraph 23.70 to determine whether they are recognised as an asset.

The SME concludes that the criteria in paragraph 23.70 are met because:

- the staff costs relate directly to the contract;
- the staff costs create a resource (a work in progress) that the SME will use to provide the customer with the professional opinion in Year 2, at which point the promise will be fulfilled; and
- the SME expects to recover the staff costs through sale proceeds.

The SME recognises the staff costs of working on the professional opinion as an asset.

Equipment costs

Section 17 covers depreciation of equipment and requires such costs to be recognised as an asset if required by another section of the Standard (see paragraph 17.17). The section does not cover costs associated with maintaining equipment. Therefore, the SME accounts for the equipment costs based on the treatment of the associated staff costs.

The SME recognises the equipment costs allocated to working on the professional opinion as an asset.

Example—Costs to fulfil a contract (costs give rise to an asset)

Ex 80 An SME enters into a contract with a customer to demolish a building. The demolition will begin at the start of Year 2 and is expected to take 18 months. During Year 1, the SME transports equipment from its warehouse to the demolition site.

The SME accounts for the demolition service as a single promise fulfilled over time.

The costs of transporting the equipment to the demolition site are costs incurred as part of fulfilling the contract.

The transportation costs are not covered by Section 17. Therefore, the costs are assessed against the criteria in paragraph 23.70.

At the end of Year 1, the SME concludes that the criteria in paragraph 23.70 are met because:

- the equipment, and the costs of transporting it, relate directly to the contract;
- the transportation costs improve the SME's resources by moving the SME's equipment so it can be used by the SME to demolish the building during Year 2 and Year 3, when the promise will be fulfilled; and
- the SME expects to recover the transportation costs through sale proceeds.

The SME recognises the costs of transporting the equipment as an asset.

Example—Costs to fulfil a contract (costs recognised as an expense as incurred)

Ex 81 An SME enters into a contract with a customer to provide maintenance services for two years. The SME assigns four employees to spend all their time providing the maintenance services to the customer.

The SME accounts for the maintenance service as a single promise fulfilled over time.

The costs of the employees are costs incurred as part of fulfilling the contract.

Section 28 covers staff costs but requires such costs to be recognised as an asset if required by another section of the Standard. Other than Section 28, the costs are not covered by another section of the Standard. Therefore, the costs are assessed against the criteria in paragraph 23.70 to determine if they are required to be recognised as an asset.

The SME concludes that the criterion in paragraph 23.70(b) is not met because the staff costs do not create or improve the SME's resources. Instead, the costs improve the resources of the customer. In addition, the costs relate to maintenance services that have already been provided.

Therefore, the SME cannot recognise the costs as an asset and instead recognises them as an expense when incurred.

Measurement after recognition

23.74 After initial **recognition**, an entity shall measure assets arising from the costs to fulfil a contract in accordance with paragraph 23.70 at cost less accumulated **amortisation** and any accumulated **impairment losses**:

(a) an entity shall amortise the asset based on the pattern of transfer of the goods or services to which the asset relates.

...

Educational notes

The amortisation and impairment requirements in Section 23 apply only to assets arising from the costs incurred to fulfil a contract recognised in accordance with the criteria in paragraph 23.70. Costs incurred to fulfil a contract recognised as assets in accordance with another section of the Standard are subject to the amortisation and impairment requirements in that section.

Amortisation

The amortisation period for assets arising from the costs to fulfil a contract is based on the pattern of transfer of the goods or services to which the asset relates.

The pattern of transfer of the goods or services is typically the same as the pattern of revenue recognition. If this is the case, the entity can amortise the asset based on the pattern of revenue recognition for the contract.

However, the pattern of transfer of the goods or services might differ from the pattern of revenue recognition if the consideration includes a variable amount. A difference occurs if a portion of the variable amount was excluded from the transaction price (in accordance with Step 3) and recognised as revenue later in the contract once the goods or services have been transferred. In such instances, instead of amortising the asset based on the pattern of revenue recognition, the entity would amortise the asset based on the pattern of transfer of goods or services determined in accordance with Step 5 (see Example 84).

Examples—Amortising assets arising from costs to fulfil a contract

Ex 82 The facts are the same as in Example 79.

The SME recognises the staff costs of providing the consulting services and the allocation of the equipment costs that relate to providing those services as an asset (see Example 79).

The SME accounts for the service as a single promise fulfilled at a point in time.

The SME transfers control of the service at the point in time the professional opinion is provided. The SME amortises the asset by recognising the staff and equipment costs at this point in time. Therefore, the asset is amortised and the revenue from the contract is recognised at the same time.

Ex 83 The facts are the same as in Example 80.

At the end of Year 1, the SME recognises the costs of transporting the equipment as an asset (see Example 80).

The SME accounts for the demolition service as a single promise fulfilled over time.

During Year 1, the asset is not amortised because the demolition has yet to start (and no services have been transferred).

During Year 2 and Year 3, the asset is amortised because the service is transferred and the promise is fulfilled.

The SME measures its progress towards fulfilling the promise based on time elapsed since the start of the demolition. Because this method measures the SME's progress towards transferring the service to the customer, the SME amortises the asset on the same basis. Therefore, the asset is amortised and the revenue is recognised evenly over the demolition period.

Ex 84 The facts are the same as Examples 80 and 83. However, in this example, if the demolition is complete within 15 months, the SME will be entitled to a performance bonus.

Consistent with Example 83, the SME amortises the asset on a straight-line basis over the contract because this is the pattern of the transfer of service to the customer. However, in this example the pattern of amortisation and pattern of revenue recognition are different.

The difference between the pattern of amortisation and pattern of revenue recognition arises because the SME does not include any of the performance bonus in the transaction price in Year 1 and Year 2 of the contract. The performance bonus is excluded from the transaction price because, in accordance with Step 3, the SME concludes that the demolition will take longer than 15 months to complete. Despite its assessment, the SME completes the contract in 14 months and recognises the performance bonus in Year 3. Therefore, the revenue is not recognised on a straight-line basis over the contract.

Measurement after recognition

23.74 After initial **recognition**, an entity shall measure assets arising from the costs to fulfil a contract in accordance with paragraph 23.70 at cost less accumulated **amortisation** and any accumulated **impairment losses**:

...

(b) an entity shall follow Section 27 *Impairment of Assets* to recognise and measure the impairment of the asset. However, the entity shall apply paragraphs 23.75–23.76 instead of paragraphs 27.11–27.20 to estimate the **recoverable amount** of the asset.

23.75 For the purpose of measuring impairment losses, the recoverable amount of an asset arising from the costs to fulfil a contract is:

(a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates (see paragraph 23.76); minus

(b) the remaining costs of providing those goods or services not yet incurred.

23.76 In measuring the remaining amount of consideration, the amount shall only include consideration for which collection is probable.

Educational notes

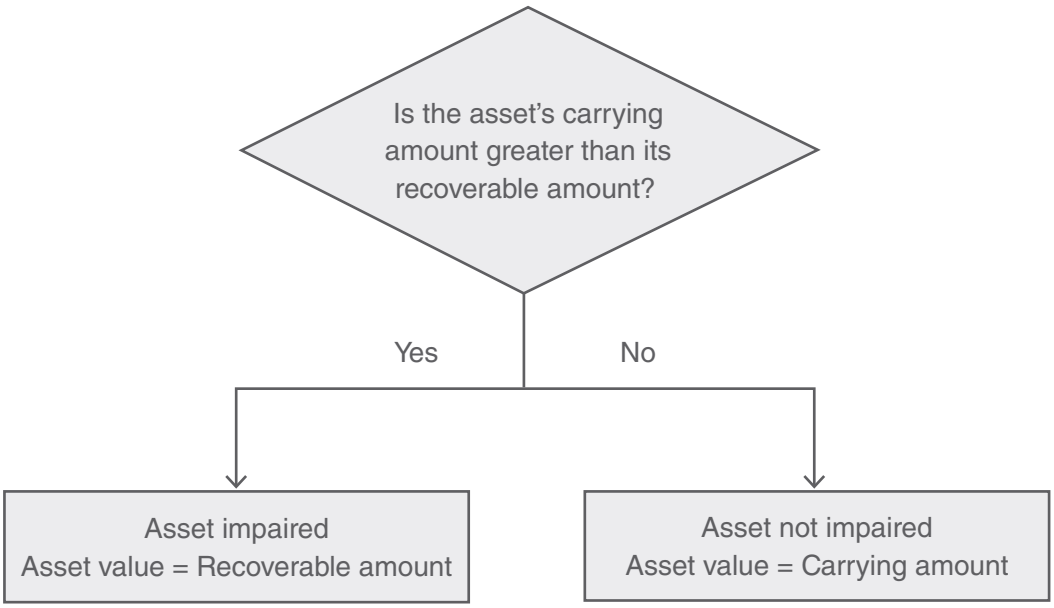
Signpost to Section 27 Impairment of Assets

The requirements covering the impairment of assets recognised from the costs to fulfil a contract direct an entity to Section 27 *Impairment of Assets*. Although Section 27 specifies when an entity impairs such assets (see paragraphs 27.7–27.10), Section 23 specifies how an entity calculates impairment losses.

Calculating impairment losses

An entity tests an asset for impairment by comparing the asset's recoverable amount with its carrying amount as shown in Figure 15. If the carrying amount before recognising the impairment loss is greater than the recoverable amount, an entity reduces the carrying amount to the recoverable amount and records an impairment loss in profit or loss.

Figure 15—Impairing assets



An asset's carrying amount is equal to the initial amount of costs recognised as an asset minus the cumulative amount of amortisation and any impairment losses recorded in profit or loss.

An asset's recoverable amount is based on the remaining amount of consideration and costs related to the goods or services to which the asset relates.

An entity can measure the remaining amount of consideration by adjusting the transaction price. Adjustments would be expected for:

- *the customer's credit risk*—the transaction price is the amount of consideration an entity expects to be entitled to, and could be different to the amount of consideration that the entity expects to receive. For example, if the financial situation of a customer deteriorates, the amount of consideration the entity expects to receive might be less than the amount of consideration to which it is entitled. When measuring the amount of consideration it expects to receive, an entity excludes from the transaction price consideration for which collection is not 'probable'. The Glossary defines probable as 'more likely than not'.
- *variable consideration*—the transaction price might include amounts of variable consideration based on the requirements in Step 3. The requirements for including variable consideration in the transaction price use a 'highly probable' threshold. The Glossary defines highly probable as 'significantly more likely than probable'. When measuring the amount of consideration it expects to receive, an entity might include variable consideration which it is probable to become entitled to, but which it is not highly probable to become entitled to, so does not meet the highly probable threshold. Consequently, the remaining amount of consideration an entity expects to receive could include amounts of variable consideration that are not included in the transaction price.

Disclosure requirements

Entities are directed to Section 27 for the recognition and measurement of assets recognised from the costs to fulfil a contract, but not the disclosure of such assets. Therefore, an entity would not apply the disclosure requirements in Section 27. Section 23 does not include any disclosure requirements relating to such assets.

Example—Impairment of assets recognised from costs to fulfil a contract

Ex 85 An SME enters into a contract with a customer to design a new logo for CU1,800.

The SME accounts for the design services as a single promise fulfilled at a point in time. The contract requires the customer to pay a 10% deposit before the SME begins designing. The remaining balance is due once the logo has been approved by the customer.

The SME recognises the staff costs of providing the design services and the allocation of the equipment costs that relate to providing those services as an asset. The estimated costs of providing the service are CU1,300. At the reporting date, the asset had a carrying amount of CU900.

Evidence from internal reporting suggests a considerable decline in the budgeted net cash flows flowing from the contract, and therefore from the asset recognised from the costs to fulfil it. The decline is due to unstable market conditions in the customer's industry which might affect the customer's ability to pay the SME. The decline in the expected future cash flows from the contract suggests that the asset might be impaired.

Because there is an indicator of impairment, the SME tests the asset for impairment by comparing its recoverable amount and carrying amount.

At the reporting date, the SME estimates that it is probable that 20% of the transaction price will not be recovered from the customer.

The recoverable amount of the asset at the reporting date is calculated as follows:

	CU	Calculation
Transaction price	1,800	
Minus consideration received at reporting date	(180)	10% × CU1,800
Minus consideration for which consideration is not probable	(360)	20% × CU1,800
Remaining amount of consideration	1,260	
Minus remaining costs of providing the service	(400)	CU1,300 – CU900
Recoverable amount	860	

The SME recognises an impairment loss at the reporting date as follows:

	CU
Carrying amount of asset before impairment loss	900
Minus recoverable amount	(860)
Impairment loss	40

Contract balances

Educational notes

The requirements for contract balances cover the presentation of assets and liabilities that arise when (or as) revenue is recognised and consideration is receivable. An entity will typically only need to consider these requirements when preparing its statement of financial position at the reporting date.

23.77 When either party to a contract has performed, an entity shall present the contract in the **statement of financial position** as either a **contract asset** or a **contract liability** based on the contract as a whole. The presentation of the contract balance depends on the relationship between:

(a) the entity's performance in transferring the goods or services promised in the contract to the customer; and

(b) the customer's payment.

Educational notes

Whether an entity presents a contract as a contract asset or a contract liability depends on the difference between:

- the amount of revenue that has been recognised (which is determined by the entity's performance in transferring goods or services to the customer); and
- the amount of consideration that has been received or receivable (which is affected by the customer's payment).

Figures 16 and 17 show what balance an entity presents depending on the relationship between the entity's performance and the customer's payment.

Figure 16—Contract liability

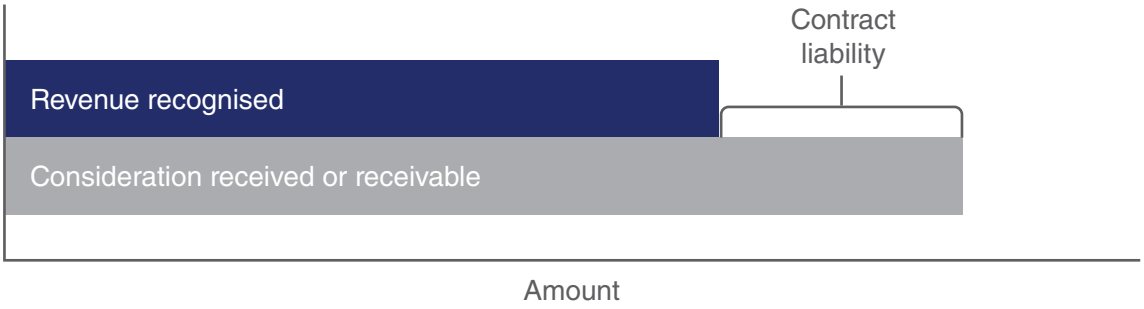


Figure 17—Contract asset

* Including trade receivables

In Figure 16, an entity presents a contract liability. A liability exists because the entity has an obligation to transfer goods or services to the customer as a result of an amount of consideration being received (or receivable) from the customer that is greater than the revenue recognised.

In Figure 17, an entity presents a contract asset. An asset exists because the entity has a right to receive consideration from the customer as a result of transferring goods or services to the customer and recognising revenue that is greater than the amount of consideration the entity has received.

Unit of account

An entity presents a contract balance based on the relationship between the entity's performance and the customer's payment for the contract as a whole. The entity does not need to consider the relationship for each promise in the contract.

23.78 If an entity has received consideration (or has a trade receivable) before it transfers goods or services to the customer, the entity shall recognise a contract liability when the payment is made or due, whichever is earlier. A contract liability is an entity's obligation to transfer goods or services to the customer for which the entity has received consideration (or for which the amount is due) from the customer. When (or as) the entity transfers those goods or services to the customer, the entity shall derecognise the contract liability (or part of a contract liability) and recognise revenue, in accordance with Step 5.

Educational notes

Contract liabilities are recognised if an entity requires a customer to pay in advance of the entity transferring goods or services to the customer.

Contract liabilities are sometimes referred to as deferred income (for example, in paragraph 4.11(d) of the Standard). However, contract liabilities are the only type of deferred income that arise from contracts with customers.

Contract liabilities can arise even if a customer has yet to make payment and the entity has an unconditional right to consideration before it transfers goods or services to the customer. For example, if consideration is due from a customer before an entity transfers goods or services, and the contract is non-cancellable, the entity recognises:

- a trade receivable, for its unconditional right to consideration (the right is unconditional because the contract cannot be cancelled once payment is due); and
- a contract liability, for the obligation to transfer goods or services to the customer for which consideration is due from the customer.

In accordance with paragraph 23.80, the entity would present the trade receivable and contract liability separately in the statement of financial position (on a gross basis).

Example—Recognition of contract liability

Ex 86 An SME provides cosmetic services to customers. To ensure commitment from its customers, the SME requires customers to pay 25% of the cost of services at the time of booking. Customers pay the remaining 75% on the date on which the service is performed.

A customer books a service on 10 December 20X1 which will take place on 20 January 20X2. The service costs CU400. The SME accounts for the service as a single promise fulfilled on 20 January 20X2.

The following journal entries illustrate how the SME accounts for the contract:[2]

(a) The SME receives cash of CU100 on 10 December 20X1 (cash received in advance of performance):

Dr	Cash		CU100	
	Cr	Contract liability		CU100

(b) The SME fulfils the promise and receives cash of CU300 on 20 January 20X2:

Dr	Contract liability		CU100	
Dr	Cash		CU300	
	Cr	Revenue		CU400

Example—Recognition of contract liability and trade receivable

Ex 87 An SME enters into a non-cancellable contract to manufacture an item of equipment. To cover the initial production costs, the SME requires the customer to pay CU5,000 before it starts manufacturing. The SME invoices the customer for this amount shortly before the reporting date. The invoice is due on issue. At the reporting date, the invoice is unpaid, and the SME has yet to start manufacturing the equipment.

The SME accounts for the promise to transfer the equipment as a single promise fulfilled at a point in time.

At the reporting date, the SME's statement of financial position includes:

- a trade receivable of CU5,000 for consideration due from the customer; and
- a contract liability of CU5,000 for the obligation to transfer the equipment to the customer.

The SME presents the trade receivable and contract liability on a gross basis in the statement of financial position.

2 This educational material includes illustrative journal entries. Please note that these are intended to illustrate one way, not necessarily the only way, in which the journal entries might be structured or processed.

23.79 If an entity transfers goods or services to a customer before the customer has paid (or before payment is due), the entity has a right to consideration. The entity shall present that right as a contract asset, excluding any amounts presented as a trade receivable (see paragraph 23.80). An entity shall assess a contract asset for impairment and recognise and measure any impairment loss in accordance with Section 11 *Financial Instruments*.

Educational notes

An entity recognises a contract asset if it transfers goods or services to a customer before the customer has paid (or before payment is due) for those goods or services. Therefore, contract assets can be considered the opposite of contract liabilities.

Contract assets are sometimes referred to as accrued income. However, contract assets are the only type of accrued income that arise from contracts with customers.

Relationship between contract assets and trade receivables

An entity excludes amounts presented as a trade receivable when presenting a contract asset.

A receivable is an entity's unconditional right to consideration, where only the passage of time is necessary before payment of that consideration becomes due (see paragraph 23.80). Excluding unconditional rights from a contract asset means the asset only includes an entity's conditional rights to consideration.

Rights to consideration are conditional if something must happen before payment of the consideration becomes due. Conditional rights are typically conditioned on the entity's future performance in transferring the goods or services to the customer. For example, an entity has a conditional right if it provides a good to the customer, but payment for the good only becomes due once the entity transfers all the goods and services promised to the customer in the contract.

Presenting trade receivables separately from contract assets distinguishes between the different risks associated with unconditional and conditional rights:

- unconditional rights (presented as trade receivables) are subject only to credit risk (the risk that the entity will not receive the consideration); and
- conditional rights (presented as contract assets) are subject to other risks in addition to credit risk, for example, performance risk.

Impairment of contract assets

Contract assets are assessed for impairment following the requirements for impairment in Part I of Section 11 *Basic Financial Instruments* (see paragraph 11.7A).

Entities are directed to Section 11 for the recognition and measurement of impairment losses on contract assets, but not for the disclosure of these impairment losses. An entity applies the disclosure requirements in paragraph 23.83(b) to such losses instead of the disclosure requirements in Section 11.

Examples—Recognition of contract asset

Ex 88 **An SME sells and installs items of machinery. Contracts with customers specify that payment for the machinery and installation is not due until 30 days after the machinery has been installed. Consequently, the SME does not have a right to consideration that is unconditional (a receivable) until the machinery has been transferred and installed.**

The SME enters into a contract to sell and install an item of machinery for CU800. The equipment will be delivered on 10 December 20X1 and installed on 20 January 20X2.

The SME accounts for the transfer and installation of the machinery as separate promises. The transaction price allocated to the promises is as follows:

Promise	Allocated transaction price
	CU
Machinery	600
Installation	200
Total	800

The following journal entries illustrate how the SME accounts for the contract:

(a) The SME fulfils the promise to transfer the machinery on 10 December 20X1 and has a right to consideration that is conditional on the installation of the machinery:

Dr	Contract asset		CU600	
	Cr	Revenue		CU600

(b) The SME fulfils the promise to install the machinery on 20 January 20X2 and has a right to consideration that is unconditional:

Dr	Trade receivable		CU800	
	Cr	Contract asset		CU600
	Cr	Revenue		CU200

Ex 89 **An SME provides logistics services. Contracts with customers specify that payment for the service is not due until the products have reached their destination.**

The SME enters into a contract to transport products from Jurisdiction A to Jurisdiction B for CU200. The SME accounts for the promise to transport the products as a single promise that is fulfilled over time.

The distance from Jurisdiction A to Jurisdiction B is 1,400 kilometres (km). At the reporting date, the SME has transported the products 700km.

In accordance with Step 5, the SME uses an output method based on distance travelled to measure its progress towards fulfilling the promise. At the end of the reporting period, the SME has recognised revenue of CU100 (CU200 × (700km ÷ 1,400km)).

The SME's right to the CU100 for the services transferred is conditional on it delivering the products to Jurisdiction B. The SME will not have a right to consideration that is unconditional (a receivable) until the products have reached Jurisdiction B. Therefore, the right to the CU100 is presented as a contract asset.

Example—Presentation of contract asset and trade receivable

Ex 90 **An SME enters into a contract to transfer a product to a customer for CU400. The customer is required to pay the SME once the product has been delivered. Shortly before the reporting date, the SME delivers the product and invoices the customer for CU400. Payment is due after the reporting date.**

The SME accounts for the promise to transfer the product as a single promise that is fulfilled at a point in time.

At the reporting date, the SME has a right to consideration for CU400 for the product transferred to the customer. The right to consideration is unconditional because only the passage of time is necessary before the consideration becomes due. Therefore, the right is presented as a trade receivable, not a contract asset.

Consequently, at the reporting date, the SME's statement of financial position includes:

- a trade receivable of CU400 for consideration to which the SME has an unconditional right; and
- revenue of CU400 for fulfilling the promise to transfer the product.

Example—Recognition of contract liability, contract asset and trade receivable

Ex 91 **An SME enters into a contract to build an office and maintain it for 12 months. To cover the initial costs and materials, the SME requires the customer to pay CU1,000 before it starts building. The customer will then pay:**

- **CU2,000 when the office is built and has passed an inspection to ensure it is safe for occupancy; and**
- **CU900 during the 12 months it provides the maintenance services, payable a month in arrears at CU75 per month.**

The SME accounts for the office and maintenance services as separate promises. Both promises are fulfilled over time. The transaction price is CU3,900, of which CU3,000 is allocated to the promise to build the office and CU900 is allocated to the maintenance services.

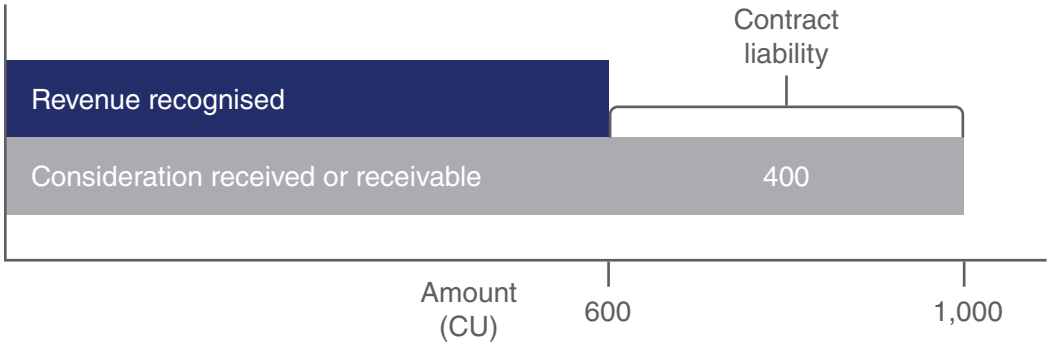
At the end of Year 1, the office is partially built, and the SME has recognised revenue of CU600. The SME has received an advance payment of CU1,000.

At the end of Year 2, the office is built but has not yet passed the inspection. The SME has provided two months of maintenance services. The SME has recognised revenue of CU3,150. The SME has received an advance payment of CU1,000 and CU75 for the first month of the maintenance services. CU75 is receivable for the second month of the maintenance services.

At the end of Year 1

Of the CU1,000 received from the customer, CU600 has been recognised as revenue. The remaining CU400 represents the amount of services that the SME has an obligation to transfer to the SME for which it has received consideration. Therefore, the SME has a contract liability of CU400.

Figure 18—Contract balance at end of Year 1

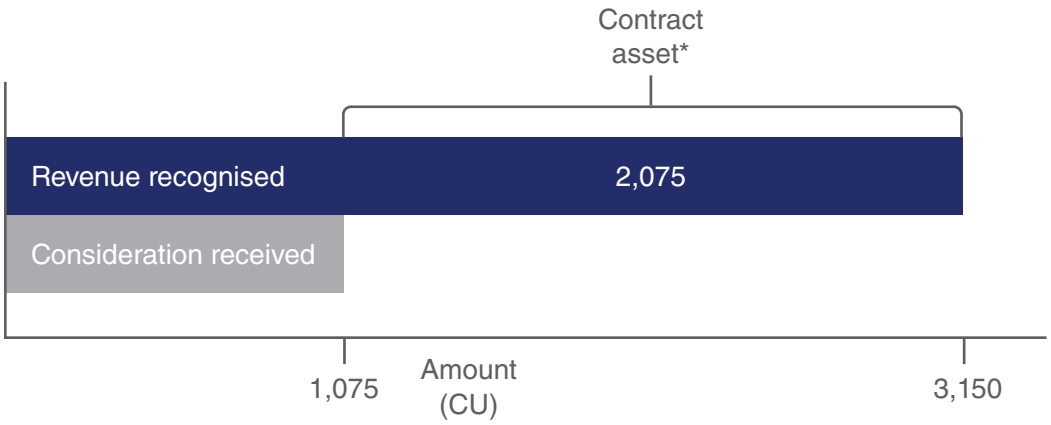


At the end of Year 2

Of the CU3,150 recognised as revenue, CU1,075 has been received from the customer. The difference of CU2,075 is the amount of consideration that the SME has a right to receive from the customer as a result of transferring goods or services to the customer. This balance is shown in Figure 19.

Of this balance, CU75 relates to the second month of the maintenance services and is unconditional. The remaining CU2,000 is conditional on the office passing the inspection. Therefore, the SME has a contract asset of CU2,000 and a trade receivable of CU75.

Figure 19—Contract balance at end of Year 2



* Including trade receivables

23.80 A receivable is an entity's unconditional right to consideration. A right to consideration is unconditional if only the passage of time is necessary before payment of that consideration becomes due. An entity can have an unconditional right to consideration even though it might be required to refund the consideration in the future (for example, when a right of return exists). In those instances, the entity might recognise a trade receivable and a refund liability. An entity shall account for a trade receivable in accordance with Section 11. An entity shall present trade receivables separately from contract assets and contract liabilities in the statement of financial position.

Educational notes

When an entity has an unconditional right to consideration

An entity recognises a receivable when it has an unconditional right to consideration.

What rights to consideration an entity has, and when those rights arise, depend on the entity's contract with its customer.

In most contracts, an entity will have an unconditional right to consideration once it fulfils the promises in the contract by transferring the goods or services to the customer. However, in long-term contracts, instead of only having an unconditional right once it fulfils the promises in the contract, an entity might have an unconditional right to an amount of consideration when it reaches a predefined point in the contract (a milestone).

Although an entity will typically have an unconditional right to consideration once it has transferred goods or services to the customer, the unconditional right could arise before or after it does so. For example:

- if an entity enters into a non-cancellable contract that requires the customer to pay the consideration before the entity transfers the goods or services (see paragraph 23.78 on contract liabilities); or
- if an entity enters into a contract in which payment of consideration is conditional on the goods or services that are transferred being inspected (see paragraph 23.79 on contract assets).

Invoicing the customer

An entity usually invoices the customer for payment once the goods or services are transferred. The invoice specifies when payment is due. However, the act of invoicing and specifying when payment is due does not demonstrate whether the entity has an unconditional right to consideration. Often, an entity that has an unconditional right to consideration has that right before it invoices.

Requirement to refund consideration

An entity that is required to refund some or all of the consideration due from a customer can still have an unconditional right to that consideration and can recognise a trade receivable.

In such instances, an entity recognises a trade receivable for the gross amount of consideration to which it is entitled and has an unconditional right. Consideration not included in the transaction price is recognised as a refund liability in accordance with the requirements for refund liabilities in Step 3 and the Appendix to Section 23.

Interaction with Section 11 Financial Instruments

Trade receivables are financial assets and accounted for in accordance with Section 11.

Initial measurement of trade receivables

Section 11 specifies requirements for the initial measurement of financial assets. In most instances, Section 11 requires trade receivables to be recognised initially at the amount determined by applying Section 23 (see paragraph 11.13A).

The only circumstance in which a trade receivable is not recognised initially at the amount determined by Section 23 is if the arrangement constitutes, in effect, a financing transaction and the entity does not apply the option in paragraph 23.38. In this circumstance, the entity applies paragraph 11.13B.

Impairment of trade receivables

Section 11 specifies requirements for the impairment of financial instruments such as trade receivables, which are measured at cost or amortised cost.

Impairment losses on trade receivables are presented as an expense in the income statement and not as part of revenue. Impairing trade receivables does not affect the amount of revenue an entity recognises.

Presentation of trade receivables

Trade receivables, contract assets and contract liabilities are required to be included in different line items in the statement of financial position—an entity might, for example:

- include trade receivables in the line item 'trade and other receivables' (see paragraph 4.2(b));
- present a separate line item for contract assets; and
- include contract liabilities in the line item 'trade and other payables' (see paragraph 4.2(l)).

Example—Recognition of trade receivable

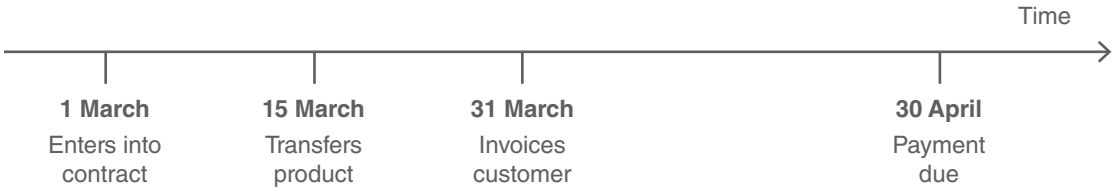
Ex 92 An SME enters into a contract on 1 March 20X1 to transfer a product to a customer for CU400.

The SME transfers the product on 15 March 20X1.

The SME bills its customers at the end of each month. Therefore, the SME invoices the customer on 31 March 20X1 for CU400 payable on normal credit terms (30 days). Payment is due on 30 April 20X1.

The events in the contract are summarised in Figure 20.

Figure 20—Contract timeline



On 15 March 20X1, the only thing that must happen before payment is due on 30 April 20X1 is the passage of time. Therefore, the SME recognises a trade receivable of CU400 on 15 March 20X1 because it has an unconditional right to consideration.

Example—Recognition of trade receivable and refund liability

Ex 93 An SME redecorates buildings for customers. Customers are entitled to a refund if they are dissatisfied with the SME's services within six months of the building being redecorated.

An SME enters into a contract to redecorate a building for CU800. At the reporting date, the SME has redecorated the building and invoiced the customer for CU600. The six-month refund period is ongoing.

In accordance with the requirements for refund liabilities in Step 3, the SME estimates a refund liability of CU32. Therefore, the transaction price is CU768 (CU800 – CU32).

At the reporting date, the SME's financial statements include:

- a trade receivable of CU800 for consideration to which the SME has an unconditional right;
- revenue of CU768 for fulfilling the promise to redecorate the building; and
- a refund liability of CU32.

Example—Impairment of trade receivable

Ex 94 An SME enters into a contract to manufacture an item of equipment for a customer for CU800.

On 17 November 20X1, the SME transfers the equipment to the customer and invoices the customer for CU800 payable on normal credit terms (60 days). Payment is due on 16 January 20X2.

In December 20X1, the customer's business is destroyed by a natural disaster and the SME realistically expects to receive only 20% of the consideration due on liquidation of the customer.

On 17 November 20X1, the SME recognises:

- a trade receivable of CU800 on 17 November 20X1 because it has an unconditional right to consideration; and
- revenue of CU800 for fulfilling the promise to manufacture the equipment.

At the reporting date (31 December 20X1), the trade receivable is tested for impairment in accordance with Section 11 (see paragraphs 11.21–11.25). Impairment losses are recognised in profit or loss immediately and revenue is unaffected by the impairment.

23.81 An entity is permitted to use different descriptions in the statement of financial position for 'contract assets' and 'contract liabilities'. If an entity uses a different description for 'contract assets', the entity shall provide enough information for a user of the financial statements to distinguish between trade receivables and contract assets.

Educational notes

Different descriptions for contract balances include:

- 'accrued income' or 'unbilled revenue' for contract assets; and
- 'deferred income' or 'prepaid revenue' for contract liabilities.

If an entity uses a different description, it should make sure the balance includes only amounts that arise from contracts with customers. Also, if an entity uses a different description for contract assets, it should make sure the balance does not include trade receivables.

Disclosures

Educational notes

The disclosure requirements in Section 23 require an entity to disclose information about the nature, amount and timing of revenue arising from contracts with customers.

23.82 An entity shall disaggregate revenue from contracts with customers using categories based on the characteristics of the entity's revenue, contracts or customers that are relevant to an understanding of its financial performance. Examples of categories that might be appropriate include:

(a) type of good or service (for example, major product lines);

(b) geographical region (for example, country or region);

(c) market or type of customer (for example, **government** and non-government customers);

(d) type of contract (for example, fixed-price and time-and-materials contracts);

(e) contract duration (for example, short-term and long-term contracts);

(f) timing of transfer of goods or services (for example, revenue from goods or services transferred to customers at a point in time and revenue from goods or services transferred over time); and

(g) nature of promise (for example, revenue from acting as a principal and revenue from acting as an agent).

Educational notes

Revenue is a composite amount that usually arises from many contracts. An entity's revenue can arise from the transfer of various goods or services, and from contracts involving various types of customers or markets. Disaggregating revenue means that users can understand the composition of revenue recognised in the current period.

Choosing categories for disaggregation

The examples in paragraph 23.82 of categories an entity might use to disaggregate revenue are not exhaustive. An entity might use different categories based on its revenue and what is relevant to an understanding of its financial performance.

An entity can identify appropriate categories by thinking about how revenue is disaggregated for management purposes.

Example—Disclosure, disaggregation of revenue

Ex 95 An SME licenses software. The financial information the SME prepares for management categorises sales figures by customer type, because the nature of the software and its margins vary by customer type.

The SME determines that disaggregating revenue by customer type provides information that would help users to understand its financial performance.

Notes to the SME's financial statements for the year ended 31 December 20X1 (extract):

...

Note 3. Revenue

	20X1 CU	20X0 CU
Licences to individual consumers	56,894	52,205
Licences to commercial organisations	346,037	304,582
Licences to government organisations	138,417	129,320
Total revenue	541,348	486,107

23.83 If not otherwise separately presented or disclosed, an entity shall disclose:

(a) the opening and closing balances of trade receivables and contract assets separately; and

(b) total impairment losses recognised on trade receivables and contract assets during the reporting period in accordance with Section 11.

23.84 An entity shall disclose:

(a) the opening and closing balances of contract liabilities, if they are not otherwise separately presented or disclosed; and

(b) revenue recognised in the reporting period that was included in the contract liability balance at the beginning of the period.

Educational notes

Comparative information

Paragraph 3.14 of the Standard requires an entity to disclose comparative information in respect of the previous comparable period for all amounts presented in its current period's financial statements. Consequently, if an entity presents one year of comparative information, the entity will disclose the

opening and closing contract balances for the comparative period. Figure 21 summarises the contract balances disclosed by such an entity.

Figure 21—Contract balances disclosed by an entity presenting one year of comparative information

Trade receivables and contract assets

The balances of trade receivables are required to be presented or disclosed separately from the balances of contract assets. The requirement for these balances to be presented or disclosed separately is consistent with the presentation requirements in paragraph 23.80. An entity is not required to distinguish between impairment losses recognised on trade receivables and those recognised on contract assets.

The amounts disclosed in accordance with paragraph 23.83 include only those arising from contracts with customers.

Contract liabilities

Entities that receive consideration before they transfer goods or services to a customer typically transfer those goods or services to the customer within one year of the consideration being received. In such instances, the entire amount of the opening contract liability balance will be recognised as revenue in the reporting period and disclosed in accordance with paragraph 23.84(b).

However, some of the opening contract liability balance might remain unrecognised as revenue in the reporting period if the balance includes short-term contracts where there has been a delay in progress, or long-term contracts. Paragraph 23.84(b) requires an entity to disclose revenue recognised in the reporting period that was included in the opening contract liability balance. If the opening contract liability balance includes such contracts, not all of the balance will be recognised as revenue in the reporting period and disclosed in accordance with paragraph 23.84(b).

Example—Disclosure, contract balances

Ex 96 The following disclosure illustrates one way of satisfying the requirements in paragraphs 23.83–23.84.

It assumes the SME discloses balances of trade receivables, and impairment losses recognised on these balances, elsewhere in the financial statements.

Notes to the SME's financial statements for the year ended 31 March 20X2 (extract):

Note 14. Contract balances			
	20X2	**20X1**	**20X0**
	CU	**CU**	**CU**
Contract assets	658,621	538,773	612,540
Contract liabilities	(258,733)	(201,871)	(241,054)

The contract liability balance at the beginning of both the current and the previous reporting period was recognised as revenue during those reporting periods.

23.85 An entity shall disclose information about its promises in contracts with customers, including a description of:

(a) when the entity typically fulfils its promises (for example, upon shipment, upon delivery, as services are rendered or upon completion of service);

(b) the main payment terms (for example, when payment is typically due, whether the contract constitutes a financing transaction and whether the consideration includes a variable amount);

(c) the nature of the goods or services that the entity has promised to transfer to customers, highlighting any promises to arrange for another party to transfer goods or services if the entity is an agent;

(d) obligations for returns, refunds and other similar obligations; and

(e) types of warranties and related obligations.

Educational notes

An entity would be expected to disclose information about its promises in contracts with customers as part of its accounting policy for revenue (see paragraph 8.5 of the Standard).

An entity might have multiple sources of revenue that are different in nature and therefore promises that are dissimilar to one another. Consequently, the entity might need to disclose the information required by paragraph 23.85 for each source of revenue.

When the entity typically fulfils its promises (paragraph 23.85(a))

When a promise is fulfilled (and revenue is recognised) is determined by Step 5 of the revenue recognition model. The promise will be fulfilled over time or at a point in time.

Main payment terms (paragraph 23.85(b))

The main payment terms consist of when payment is due and whether the requirements in Step 3 of the revenue recognition model covering variable consideration and deferred payment apply.

Nature of the goods or services that the entity has promised to transfer to customers (paragraph 23.85(c))

For most contracts, an entity will be able to easily identify the goods or services it has promised to transfer. However, identifying the goods or services an entity transfers when another party is involved in providing the goods or services to the customer involves determining whether the entity is a principal or agent (see paragraphs 23A.14–23A.20).

Obligations for returns, refunds and other similar obligations (paragraph 23.85(d))

In a contract where a customer has a right to return the product or receive a refund, whether an entity recognises a refund liability will depend on the likelihood of the return or refund. Regardless of whether the entity recognises a refund liability, it is still required to describe any obligations for returns or refunds in accordance with paragraph 23.85(d).

Types of warranties and related obligations (paragraph 23.85(e))

In a contract where a good or service is sold with a warranty, whether an entity accounts for the warranty as a separate promise depends on whether the customer can choose to buy the good or service with or without the warranty. Similarly, whether the entity recognises a provision for the warranty obligation depends on the application of Section 21 *Provisions and Contingencies*. Regardless of whether the entity accounts for the warranty as a separate promise, or recognises a provision for the warranty, it is still required to describe any warranties and related obligations in accordance with paragraph 23.85(e).

Examples—Disclosure, promises

Ex 97 An SME sells machinery and provides maintenance services.

The following disclosure illustrates one way of satisfying the requirements in paragraph 23.85.

Notes to the SME's financial statements for the year ended 31 December 20X0 (extract):

Note 2. Basis of preparation and accounting policies
... *Sales and revenue recognition* Revenue from equipment sales is recognised upon delivery and payment is typically due 30 to 60 days after delivery. No right of return exists on the sale of equipment. Equipment is warranted to be free of manufacturing defects for a period of one year from the date of delivery. When revenue is recognised, a provision is made for the estimated costs of the warranty obligation (see '*Provisions*'). Revenue from servicing agreements is recognised evenly over the agreement period and payable monthly in advance.

Ex 98 An SME operates an online booking platform for holiday accommodation.

The following disclosure illustrates one way of satisfying the requirements in paragraph 23.85.

Notes to the SME's financial statements for the year ended 31 March 20X0 (extract):

Note 3. Summary of significant accounting policies
... *Revenue* The entity recognises revenue from providing a booking website that enables customers to book holiday accommodation. The entity is an agent and recognises revenue when the accommodation is booked at an amount equal to the service fee charged on the booking. The service fee is non-refundable and included in the total booking fee paid by the customer at the time of booking. The entity then pays the booking fee, less the service fee, to the provider. After the booking is made, the entity has no further obligations to the customer.

Ex 99 An SME provides consulting services. The SME recognises revenue based on the amount of consideration it has a right to invoice in accordance with paragraph 23.67.

The following disclosure illustrates one way of satisfying the requirements in paragraph 23.85.

Notes to the SME's financial statements for the year ended 31 December 20X0 (extract):

Note 2. Principal accounting policies
... *Revenue recognition* The entity enters into contracts to provide consulting services. Revenue is recognised as the entity provides the consulting based on the entity's right to invoice the customer, which corresponds to monthly invoiced amounts. Payment is due 60 days from the invoice date.

23.86 An entity shall disclose the methods it used to measure its progress towards fulfilment of promises fulfilled over time (for example, a description of the output or input methods it used and how those methods were applied).

Educational notes

The methods that an entity used to measure its progress towards fulfilment of promises fulfilled over time is determined by Step 5 of the revenue recognition model.

An entity would be expected to disclose information about the methods it used as part of its accounting policy for revenue (see paragraph 8.5 of the Standard). This disclosure would include the inputs or outputs it used to measure its progress and how it obtained information about those inputs or outputs.

Interaction with paragraph 23.67—Right to invoice

Paragraph 23.67 permits an entity to recognise revenue based on the amount of consideration it has a right to invoice. Entities that do so are not required to measure progress towards fulfilment of the promises in the contract. Therefore, despite the promises being fulfilled over time, no disclosure would be necessary in accordance with paragraph 23.86.

Interaction with Section 10 Accounting Policies, Estimates and Errors*—Disclosure of a change in accounting estimate*

In addition to the methods an entity uses to measure its progress towards fulfilment of promises fulfilled over time, it is required to disclose any changes to the measures of progress as a change in accounting estimate in accordance with Section 10 (see paragraph 23.64).

Examples—Disclosure, methods of measuring progress

Ex 100 An SME constructs buildings. The construction of each building is typically accounted for as a single promise fulfilled over time.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.86.

Notes to the SME's financial statements for the year ended 31 December 20X0 (extract):

Note 2. Basis of preparation and accounting policies
...
Sales and revenue recognition
… Progress is measured by reference to the costs incurred on the contract to date compared to the forecasted end of build costs.

Ex 101 An SME licenses its brand to other entities. Contracts to use the SME's brand are accounted for as single promise fulfilled over time.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.86.

Notes to the SME's financial statements for the year ended 31 March 20X0 (extract):

Note 3. Summary of significant accounting policies
...
Revenue
… A time-based method is used to measure progress because licensees have unlimited use of the brand during the contract. Accordingly, revenue from licensing is recognised on a straight-line basis over the contract.

23.87 An entity shall disclose any judgements it has made that had a significant effect on the amounts it recognised in its financial statements when:

(a) determining the transaction price; and

(b) allocating the transaction price to the promises identified in the contract.

Educational notes

Paragraph 23.87 requires an entity to disclose judgements made when applying Steps 3 and 4 of the revenue recognition model. Table 3 summarises examples of judgements an entity might disclose.

Table 3—Areas of judgement in Step 3 and 4 of the revenue recognition model

Step	Area of judgement	Paragraph(s)
Step 3—Determine the transaction price	Estimating the amount of variable consideration	Paragraphs 23.26–23.32
	Determining if the contract constitutes a financing transaction	Paragraph 23.36
	Measuring the fair value of non-cash consideration	Paragraph 23A.22
Step 4—Allocate the transaction price to the promises in the contract	Estimating the stand-alone selling price when not directly observable	Paragraph 23.44
	Determining whether allocating a discount or variable consideration on a relative stand-alone selling price basis represents the amount of consideration that the entity expects to be entitled to, and if not, determining what method would represent that amount	Paragraphs 23.46–23.48

An entity would only disclose judgements that had a significant effect on the amounts recognised in its financial statements. No disclosure is necessary if the effect is not significant.

Interaction with the disclosure requirements in Section 8 Notes to the Financial Statements

An entity is required to disclose information about judgements and estimates in accordance with paragraphs 8.6 and 8.7 respectively. However, these general disclosure requirements are not the same as those in paragraph 23.87 because:

- paragraph 8.6 excludes judgements involving estimates, whereas paragraph 23.87 includes all judgements; and

- paragraph 8.7 focuses on the effect of estimates on the future carrying amounts of assets and liabilities, whereas paragraph 23.87 focuses on the effect of estimates on the amounts recognised in its current financial statements.

Although the disclosure requirements in Sections 8 and 23 are different, an entity might disclose information about the same judgement to satisfy the requirements in each section.

Examples—Disclosure, significant judgements

Ex 102 An SME constructs buildings. It enters into contracts with customers that include performance bonuses.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.87.

Notes to the SME's financial statements for the year ended 31 December 20X0 (extract):

Note 2. Basis of preparation and accounting policies
...
Sales and revenue recognition
... Several contracts with customers include performance bonuses for early or on-time completion of building work. Judgements were made about the outcome of these contracts when estimating the amount of the bonus to include in the contract's transaction price and recognise as revenue.

Ex 103 An SME sells equipment. It also sells maintenance plans with the equipment. It does not sell maintenance plans for equipment that customers have bought elsewhere. The SME accounts for equipment and maintenance plans as separate promises.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.87.

Notes to the SME's financial statements for the year ended 31 March 20X0 (extract):

Note 3. Summary of significant accounting policies
...
Revenue
... For all sales of equipment and maintenance, the invoice price is allocated based on the relative stand-alone selling price of the equipment and maintenance. Because maintenance services are not sold separately, the stand-alone selling price of each service is estimated using its expected cost plus a margin.

23.88 An entity shall disclose the closing balance of assets arising from the costs to fulfil a contract (in accordance with paragraph 23.70) by main category of asset (for example, pre-contract costs and set-up costs).

Educational notes

The disclosure requirement is applicable only to costs to fulfil a contract recognised in accordance with paragraph 23.70. Costs to fulfil a contract recognised as an asset in accordance with another section of the Standard are covered by the disclosure requirements in that section.

The categories included as an example in paragraph 23.88 focus on when the costs were incurred, however the categorisation might focus on the nature or function of the costs (see Example 104).

Example—Disclosure, assets arising from costs to fulfil a contract

Ex 104 An SME provides facility management services. It recognises as an asset the set-up costs associated with each new site it manages.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.88.

SME's statement of financial position for the year ended 31 December 20X2 (extract):

	Notes	20X2	20X1
...		CU	CU
ASSETS			
Current assets			
Cash		8,546	9,875
Trade and other receivables	12	17,633	18,874
Contract assets		4,022	5,907
Contract fulfilment assets	14	3,896	2,932
		34,097	37,588
...			

Notes to the SME's financial statements for the year ended 31 December 20X2 (extract):

Note 14. Contract fulfilment assets		
	20X2	**20X1**
	CU	**CU**
IT system set-up	665	340
Site set-up	2,384	1,756
Compliance set-up	847	836
	3,896	2,932

23.89 If an entity chooses to use the option in paragraph 23.38 not to account for interest revenue separately from revenue from contracts with customers, it shall disclose that fact.

Educational notes

The option in paragraph 23.38 permits an entity not to discount the promised amount of consideration and account for interest separately if, at the start of a contract, the entity expects a customer to pay for goods or services within one year of the entity transferring the goods or services.

An entity discounts the promised amount of consideration if payment is deferred and the arrangement constitutes a financing transaction (see paragraph 23.36). Therefore, the disclosure in paragraph 23.89 is required only if the entity has such contracts with customers. If the entity has no contracts that constitute financing transactions, no disclosure would be necessary in accordance with paragraph 23.89.

Example—Disclosure, option in paragraph 23.38

Ex 105 An SME sells items of furniture on credit and applies the option in paragraph 23.38 not to account for interest revenue separately from revenue from contracts with customers.

The following disclosure illustrates one way of satisfying the requirement in paragraph 23.89.

Notes to the SME's financial statements for the year ended 31 December 20X0 (extract):

Note 2. Basis of preparation and accounting policies
Sales and revenue recognition
... Interest revenue on credit sales is recognised as the interest accrues. However, the entity does not account for interest revenue separately from revenue from selling furniture where it expects the customer will pay for the furniture within one year of it being delivered.

23.90 If an entity cannot account for an option to acquire additional goods or services that meets the criteria in paragraph 23A.9(a) as a separate promise without undue cost or effort, the entity shall disclose that fact and the reasons why accounting for the option as a separate promise would involve undue cost or effort.

Educational notes

Although the disclosure requirement is expressed in relation to one option, an entity might apply the exemption to many customer options during its reporting period. In such instances, the disclosure would need to explain why accounting for many options as separate promises would involve undue cost or effort.

Example—Disclosure, undue cost or effort exemption

Ex 106 An SME runs a chain of restaurants and operates a customer loyalty scheme.

The following disclosure illustrates one way of satisfying the requirements in paragraph 23.90.

Notes to the SME's financial statements for the year ended 31 March 20X0 (extract):

Note 2. Summary of significant accounting policies
...
Sales and revenue recognition
... Each restaurant runs a loyalty scheme through which customers are given the option to acquire additional food items for free if they make a specific number of purchases. Whether these options are redeemed is not tracked. Therefore, the options arising from the loyalty scheme are not accounted for separately because doing so would involve undue cost or effort.

Appendix to Section 23
Application guidance

This appendix is an integral part of Section 23.

23A.1 This guidance focuses on features found in some contracts with customers. The guidance covers:

(a) contract modifications (see paragraphs 23A.2–23A.4);

(b) warranties (see paragraphs 23A.5–23A.7);

(c) customer options for additional goods or services (see paragraphs 23A.8–23A.13);

(d) principal versus agent considerations (see paragraphs 23A.14–23A.20);

(e) non-cash consideration (see paragraphs 23A.21–23A.22);

(f) sales with a right of return (see paragraphs 23A.23–23A.27); and

(g) licensing (see paragraphs 23A.28–23A.37).

Educational notes

Section 23 and the Appendix to Section 23 have equal authority.

The requirements in Section 23 cover the basic revenue recognition model and apply to all contracts with customers.

The requirements in the appendix apply to more complex contracts with customers and relate to different steps of the revenue recognition model. The requirements are signposted in Section 23, in the steps to which they relate.

Contract modifications

23A.2 A contract modification is a change in the scope or price (or both) of a contract that the parties to the contract approve. A contract modification either changes the existing rights and obligations in a contract or creates new ones.

Educational notes

The requirements for contract modifications relate to Step 1 of the revenue recognition model. Paragraph 23A.2 describes what contract modifications are and paragraphs 23A.3–23A.4 then describe how an entity accounts for such modifications depending on their nature.

An entity might change the terms of a contract with a customer for various reasons and in different ways.

An entity distinguishes contract modifications from other changes to a contract based on whether the existing rights or obligations in the contract are changed, or new rights or obligations are created. The rights and obligations created by a contract are discussed in the Educational notes on paragraph 23.6.

A change to the price of the contract is a contract modification because it changes the right and obligation set out in Figure 22.

Figure 22—Right and obligation for consideration in a contract

Customer	has	an obligation	to transfer	consideration
Reporting entity		a right	to receive	

Similarly, a change to the goods or services to be transferred is a contract modification because it changes the right and obligation set out in Figure 23.

Figure 23—Right and obligation for goods or services in a contract

Customer	has	a right	to receive	goods or services
Reporting entity		an obligation	to transfer	

A change to a contract does not need to be in writing to be a contract modification; however, the change is required to be approved by the entity and the customer.

Examples—Identifying contract modifications

Ex 107 An SME enters into a contract with a customer to refurbish 10 properties.

While the contract is in progress, the customer asks the SME to refurbish an additional four properties. The SME agrees to perform the additional work for an additional amount of consideration.

The change is a contract modification because it is a change in the scope of the contract that the SME and the customer have approved. The additional work creates new rights and obligations for the SME and customer.

Ex 108 An SME enters into a contract with a customer to provide 2,000 shirts branded with the customer's logo. During negotiation of the contract, the customer shares an image of the logo with the SME.

After the contract has been agreed, the SME and the customer decide that it would be helpful for the previously shared image to be included as an annex to the contract. Therefore, the contract is changed to include an annex.

The change to the contract formally documents what was already understood between the SME and the customer and does not change the existing rights and obligations in a contract or create new ones. Therefore, the change is not a contract modification.

23A.3 An entity shall account for a contract modification as a separate contract if:

(a) additional goods or services are promised that are distinct from those in the original contract; and

(b) the price of the original contract increases by an amount that reflects the stand-alone selling price of the additional goods or services and any appropriate change to that price to reflect the circumstances of the modified contract.

23A.4 For a contract modification that is not a separate contract in accordance with paragraph 23A.3, an entity shall account for the contract modification in one of two ways. If the goods or services an entity will transfer after the contract modification are:

(a) *distinct* from the goods or services the entity has transferred before the contract modification, the entity shall account for the contract modification as if the original contract had been cancelled and a new contract created. The transaction price for the new contract is the sum of:

(i) the consideration included in the estimate of the transaction price for the original contract that the entity did not recognise as revenue; and

(ii) any increase or decrease in consideration promised as part of the contract modification.

(b) *not distinct* from the goods or services the entity has transferred before the contract modification, the entity shall account for the contract modification as if it had always been part of the original contract. The entity shall recognise the change in the transaction price and the entity's measure of progress towards fulfilment of the promise as an adjustment to revenue at the date of the contract modification (that is, on a cumulative catch-up basis).

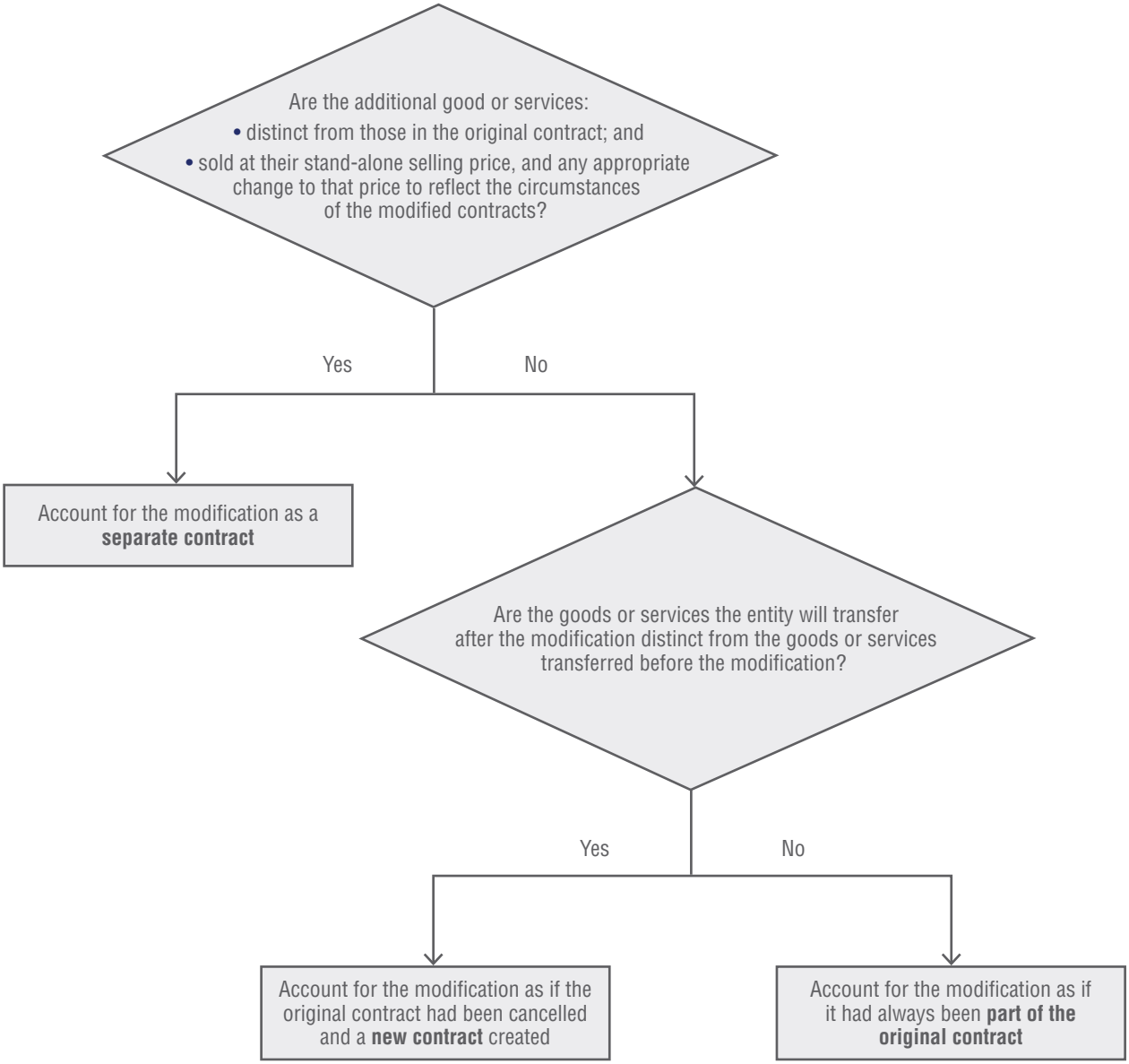
Educational notes

An entity accounts for a contract modification as either:

- a separate contract;
- a new contract; or
- part of the original contract.

Figure 24 summarises the assessment an entity makes to determine how to account for a contract modification. The assessment requires an entity to first determine if the contract modification is accounted for as a separate contract. If not, the entity then assesses if the contract modification is accounted for as a new contract or part of the original contract.

Figure 24—Accounting for contract modifications



Accounted for as a separate contract

An entity accounts for a contract modification as a separate contract if it meets both criteria in paragraph 23A.3.

The criterion in paragraph 23A.3(a) is met if the additional goods or services promised are distinct from those goods or services promised in the original contract. An entity would be expected to look at paragraphs 23.18–23.22 to determine whether the additional goods or services are distinct from the original goods or services.

The criterion in paragraph 23A.3(b) is met if the price of the original contract has increased in a way that reflects the stand-alone selling price of the additional goods or services, with any appropriate changes. It can be more challenging to determine whether this criterion is met than the criteria in paragraph 23A.3(a). It might be easy for an entity to identify the stand-alone selling price of the additional goods or services, but deciding whether any changes made to those prices reflects the circumstances of the modified contract can be more difficult because it involves more judgement. An example of an appropriate change would be if an entity sells additional goods at a discount to their stand-alone selling price because, by selling them to a customer with an ongoing contract, the entity avoids incurring the selling-related costs that it would incur if selling them to a new customer (see Example 109).

Accounting for a contract modification as a separate contract means the accounting for the original contract continues unchanged and the additional goods or services are accounted for as a new contract. Because the accounting for the original contract is unchanged, the revenue already recognised is not retrospectively adjusted.

If not accounted for as a separate contract

If a contract modification is not accounted for as a separate contract, the entity assesses whether the goods or services it will transfer *after* the modification are distinct from those transferred *before* the modification.

The goods or services the entity will transfer after the modification include:

- goods or services in the original contract that have yet to be fulfilled; and
- goods or services added or changed by the modification.

Therefore, the entity makes the assessment based on the remaining goods or services to be transferred in accordance with its revised obligations.

Similarly to the assessment required by paragraph 23A.3(a), an entity would be expected to apply paragraphs 23.18–23.22 to determine whether the goods or services it will transfer after the modification are distinct from those transferred before the modification.

Accounted for as a new contract

If the goods or services are distinct, the entity accounts for the modification as if the original contract has been cancelled and a new one created. The new contract is made up of the goods or services in the original contract that have yet to be fulfilled, plus goods or services added or changed by the modification. Because the accounting for the original contract is unchanged, the revenue already recognised is not retrospectively adjusted.

Accounted for as part of the original contract

If the goods or services are not distinct, the entity accounts for the modification as if the new terms have been in place since the start of the contract. The entity updates the original contract to include the changes arising from the modification and calculates the amount of revenue that would have been recognised based on this revised contract. The revenue recognised by the entity based on the original contract is then adjusted to equal this amount. This 'catch-up' adjustment is made at the date of the contract modification and therefore only the revenue in the current period is adjusted.

Example—Modification accounted for as a separate contract

Ex 109 An SME enters into a contract with a customer to refurbish 10 properties at a fixed price of CU2,000 per property.

While the contract is in progress, the SME agrees to refurbish an additional four properties for additional consideration of CU7,200.

The refurbishment of the additional four properties is distinct from the refurbishment of the 10 properties in the original contract.

The price of the original contract increases by CU7,200, which is CU1,800 per additional refurbished property (CU7,200 ÷ 4 properties). The estimated stand-alone selling price of each refurbished property is CU2,000. The reduction to the stand-alone selling price of CU200 (CU2,000 – CU1,800) reflects the fact that the SME did not have to incur any additional costs to bid for this additional work.

Therefore, the contract modification meets both criteria in paragraph 23A.3 and the SME accounts for the promise to refurbish the four additional properties as a separate contract from the original contract to refurbish 10 properties.

Example—Modification accounted for as a new contract

Ex 110 An SME enters into a contract with a customer to sell a product and provide a training course on how to operate the product for CU500.

The SME transfers the equipment at the end of 20X1 and delivers the training course during the first month of 20X2.

At the beginning of 20X2, before the training course starts, the SME agrees to provide a manual on how to operate the equipment for CU30. The stand-alone selling price of the manual is CU100.

At the start of the contract, the SME concludes that the product and training course are distinct and result in two promises. The transaction price of CU500 is allocated equally between the two promises and the SME recognises revenue of CU250 in 20X1 when it transfers the product.

At the date of the modification, the SME assesses that the promise to transfer the manual is distinct from the promises to transfer the product and training course. However, the additional consideration promised for the manual (CU30) does not reflect its stand-alone selling price (CU100). Therefore, the SME does not account for the contract modification as a separate contract.

The SME also assesses that the good and service to be transferred (the manual and training course) are distinct from the equipment that has already been transferred. Therefore, the SME accounts for the contract modification as a new contract.

The transaction price of the new contract is CU280 and is made up of:

- the consideration included in the original contract not recognised as revenue (CU500 – CU250 already recognised as revenue = CU250); and
- the additional consideration promised for the manual (CU30).

` The SME determines the stand-alone selling prices of the training and manual as follows:

Promise	Stand-alone selling price
	CU
Training	300
Manual	100
Total	400

The SME allocates the transaction price of CU280 proportionately between the product and training course on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Training	210	CU280 × (CU300 ÷ CU400)
Manual	70	CU280 × (CU100 ÷ CU400)
Total	280	

In 20X2, the entity recognises revenue of CU210 as it delivers the training and revenue of CU70 when it transfers the manual.

Example—Modification accounted for as part of original contract

Ex 111 An SME enters into a contract to construct a building for CU100,000.

The SME accounts for the contract as a single promise fulfilled over time.

By the end of 20X1, the SME has fulfilled 70% of the promise based on costs incurred.

At the beginning of 20X2, the SME and the customer agree to modify the contract by changing the floor plan of the building. Changing the floor plan increases the transaction price by CU15,000 to CU115,000 (CU100,000 + CU15,000).

The additional goods and services the SME will transfer as a result of the contract modification are part of the single promise to construct a building. Consequently, the SME does not account for the contract modification as a separate contract or new contract. Instead, the SME accounts for the modification as if it were part of the original contract and recognises a 'catch-up' adjustment at the date of the modification.

The adjustment is calculated as the difference between:

- the cumulative revenue recognised at the date of the contract modification based on the original contract (CU100,000 × 70% = CU70,000); and
- the cumulative revenue recognised at the date of the contract modification based on the revised contract. Because the modification has increased the scope of the contract, and total expected costs, the SME has fulfilled 65% of the promise at the date of the contract modification based on costs incurred. The SME calculates the cumulative revenue based on the revised contract as CU74,750 (CU115,000 × 65%).

Therefore, the SME recognises additional revenue of CU4,750 (CU74,750 – CU70,000) at the date of the contract modification.

Warranties

23A.5 An entity might sell a good or service with a warranty.

23A.6 If a customer can choose to buy the good or service either with or without a warranty, the warranty is distinct. In these circumstances, an entity shall account for the warranty as a separate promise and allocate a portion of the transaction price to that promise.

23A.7 If the customer has no option to buy the good or service without a warranty, the warranty is not distinct. In these circumstances, an entity shall account for the warranty in accordance with Section 21 *Provisions and Contingencies*.

Educational notes

The requirements for warranties relate to Step 2 of the revenue recognition model.

How warranties are described, and their nature, can differ. For example, an entity might sell a product with:

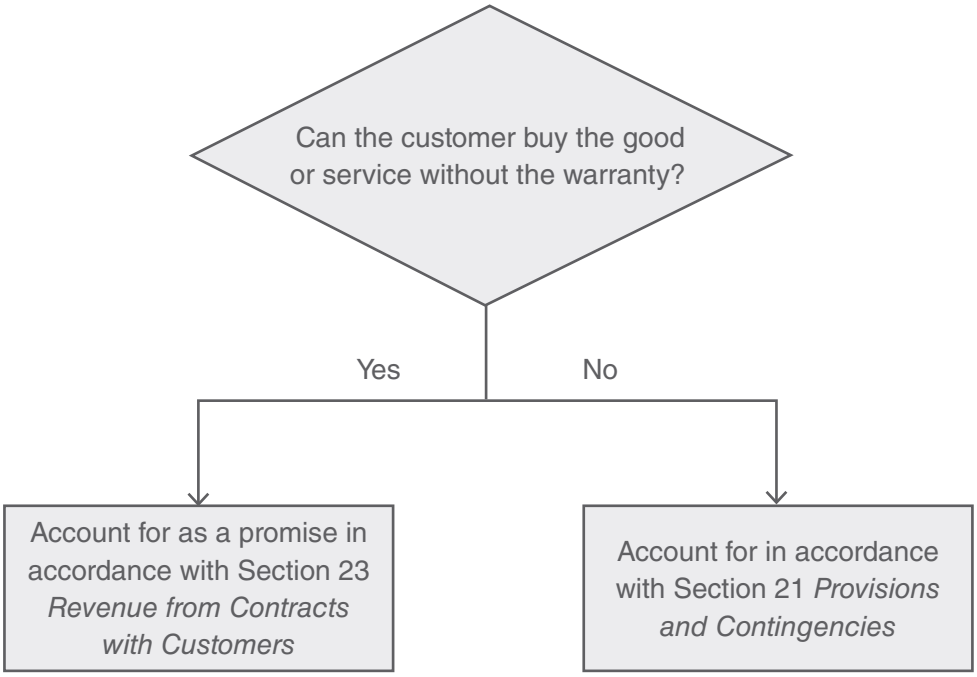
- a statutory warranty, which requires the entity to repair or replace products that develop faults within a specified period from sale; or
- an extended warranty, which requires an entity to service a product annually for a set number of years.

In some contracts, an entity might sell a product with two types of warranties (for example, a statutory and extended warranty—see Example 113).

Accounting treatment

How an entity accounts for warranties depends on whether the customer can choose to buy the good or service with or without a warranty. The accounting treatment is summarised in Figure 25.

Figure 25—Accounting for warranties



If the customer can buy the good or service without the warranty, an entity would:

- *revenue*—allocate a portion of the transaction price to the warranty and recognise that amount as revenue over the warranty period in accordance with Steps 4 and 5; and
- *costs*—account for the costs of fulfilling the warranty in accordance with paragraphs 23.69–23.76.

If the customer cannot buy the good or service without the warranty, an entity would:

- *revenue*—not allocate any of the transaction price to the warranty and not consider the warranty when identifying promises in the contract. Any consideration associated with the warranty would be recognised as revenue when (or as) the good or service sold with the warranty is transferred to the customer.
- *costs*—account for the costs of fulfilling the warranty in accordance with Section 21 *Provisions and Contingencies*. A provision would be recognised for the costs if the warranty met the conditions in paragraph 21.4.

Separately priced

A warranty will often not be separately priced in contracts where a customer has no option to buy the good or service without a warranty. However, an entity might sometimes separately price the warranty for regulatory or commercial reasons, despite customers having no option to buy it separately. As the customer has no option to buy the good or service without the warranty, the entity's decision for it to be separately priced does not affect how it is accounted for.

Manufacturers' or third-party warranties

An entity might sell a good or service with a warranty, but the warranty is provided by another party (for example, the manufacturer of the product or a third party) instead of the entity itself. If the warranty is distinct (that is, a customer can buy the good or service without the warranty), the entity would consider whether it is an agent who arranges for the other party to provide the customer with the warranty. In such instances, the entity would recognise as revenue the commission or fee it expects to be entitled to for doing so in accordance with paragraph 23A.20 (see Example 114).

An entity might also facilitate or administer warranties provided by other parties on their behalf. For example, a customer might return faulty products to the entity who then assesses them for repair under the manufacturer's warranty, before returning them to the manufacturer. In such instances, the entity would consider its agreement with the third party for providing this service and whether to recognise revenue in accordance with Section 23 (see Example 115).

Example—Statutory warranty

Ex 112 An SME enters into a contract with a customer to manufacture an item of machinery. Local legislation requires entities to provide warranties with the sale of their products. Consequently, the SME sells the machinery with a warranty.

Because a customer cannot buy the machinery without the warranty, the warranty is not distinct. The SME does not allocate any of the transaction price to the warranty and does not consider the warranty when identifying promises in the contract. The costs of fulfilling the warranty are accounted for in accordance with Section 21.

Example—Entity sells two types of warranties

Ex 113 An SME runs a car dealership. All cars are sold with a manufacturer's warranty, which customers cannot buy a car without. The SME also sells optional extended warranties, which cover repairs not covered by the manufacturer's warranty. The extended warranties are provided by the SME, not the car manufacturer.

Because a customer cannot buy a car without the manufacturer's warranty, the manufacturer's warranty is not distinct. Because the car manufacturer fulfils the warranty, not the SME, the SME does not recognise the costs of fulfilling the warranty and no provision is recognised in accordance with Section 21.

Because a customer can buy a vehicle without an extended warranty, the extended warranty is distinct. The SME allocates a portion of the transaction price to the extended warranty and recognises that amount as revenue over the warranty period in accordance with Steps 4 and 5. The costs of fulfilling the extended warranty are accounted for as costs of fulfilling a contract.

Example—Entity sells warranties as agent

Ex 114 The facts are the same as in Example 113. However, in this example, the extended warranties are provided by the car manufacturer, not the SME.

Because a customer cannot buy a car without the manufacturer's warranty, the manufacturer's warranty is not distinct. Because the car manufacturer fulfils the warranty, not the SME, the SME does not recognise the costs of fulfilling the warranty and no provision is recognised in accordance with Section 21.

Because a customer can buy a vehicle without an extended warranty, the extended warranty is distinct. The SME applies paragraphs 23A.14–23A.20 to determine whether it acts as the agent in arranging for the car manufacturer to provide the customer with the extended warranty. Because the SME does not control the right to the extended warranty before it is transferred to the customer, it determines that it is the agent. The SME recognises as revenue the commission it is entitled to from the manufacturer for selling extended warranties.

Example—Entity administers manufacturer's warranties

Ex 115 An SME sells electrical products. The products stocked by the SME are sold with a manufacturer's warranty. If a product develops a fault within the warranty period, the customer brings the product to the SME, who diagnoses the issue and ships the product to the manufacturer. The SME charges the manufacturer a service fee for processing warranty claims on the manufacturer's behalf based on the number of claims processed.

Because customers cannot buy products without a manufacturer's warranty, the warranties are not distinct. Because the manufacturer fulfils the warranties, not the SME, the SME does not recognise the costs of fulfilling the warranties and no provision is recognised in accordance with Section 21.

The service that the SME provides to the manufacturer is the act of standing ready to process warranty claims on its behalf. The SME accounts for the contract as a single promise because the contract is a series of distinct services that are essentially the same and have the same pattern of transfer to the manufacturer (see paragraph 23.15).

The fee charged for processing each warranty claim is variable consideration and allocated to each day of service based on the number of warranty claims the SME processes that day (see paragraph 23.48). Consequently, the service fee charged is recognised as revenue as each claim is processed.

Customer options for additional goods or services

23A.8 An entity might grant customers the option to acquire additional goods or services for free or at a discount. Such options include sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.

23A.9 An entity shall account for an option to acquire additional goods or services as a separate promise if:

(a) the option gives the customer a material right that:

(i) is only available to a customer that has entered into that contract; and

(ii) allows a customer to acquire an additional good or service at a discount to its stand-alone selling price; and

(b) the option can be accounted for as a separate promise without undue cost or effort.

Educational notes

The requirements for customer options for additional goods or services relate to Step 2 of the revenue recognition model.

A customer option arises where a customer enters into a contract with an entity that entitles the customer to acquire goods or services for free or at a discount when it enters into a new contract with the entity. For example, a customer might enter into a contract with an entity to purchase a product. As a consequence, the entity grants the customer loyalty points that can be used to purchase products at a discount if the customer enters into a new contract with the entity.

Distinguishing between an option and a marketing or promotional offer

The criteria in paragraph 23A.9(a) help distinguish customer options from other types of marketing or promotional offers that an entity might grant to its customers. The criteria are typically met for options that allow a customer to acquire additional goods or services for free.

Only available to a customer that has entered into that contract (paragraph 23A.9(a)(i))

The criterion focuses on whether the discount granted to the customer is unique compared with the other discounts the entity offers to customers that have not entered into the contract (that is, promotional offers awarded to new customers). To determine whether the criterion is met, the entity would be expected to review the discounts it offered to customers around the time that the option was granted. If the discount was offered only to customers that had entered into the contract, the criterion would be met. However, if a similar discount was offered to new customers, the criterion would not be met.

Allows a customer to acquire an additional good or service at a discount to its stand-alone selling price (paragraph 23A.9(a)(ii))

The criterion focuses on whether the option granted to the customer means the price of the good or service is lower than the price the entity would charge if the customer was to purchase the good individually (that is, does the option represent a genuine discount?). If the entity would ordinarily sell the good or service at a lower price, the option represents a marketing offer aimed at encouraging customers to purchase additional goods or services at a premium and the criterion would not be met.

Paragraphs 23.42–23.44 cover how an entity measures the stand-alone selling price of a good or service.

Undue cost or effort exemption (paragraph 23A.9(b))

An entity determines whether an option can be accounted for as a separate promise without undue cost or effort when identifying the promises in the contract (that is, applying Step 2). Consistent with the identification of promises, an entity would not be expected to revisit this judgement.

Accounting for an option as a separate promise would involve undue cost or effort if the incremental cost or additional effort to the entity of doing so substantially exceeds the benefits that having the information would provide users of the entity's financial statements.

Assessing whether accounting for an option will involve undue cost or effort—Benefit to user

When an entity sells a good or service that includes an option to acquire additional goods or services for free or at a discount, the customer is effectively paying the entity in advance for all or a portion of those future goods or services. To faithfully represent the rights and obligations created by the option, the entity would defer a portion of the customer's payment and recognise the portion when the goods or services are transferred or the option expires (that is, account for the option as a separate promise).

Whether accounting for an option as a separate promise would affect the information provided to users of an entity's financial statements depends on the portion of the payment allocated to the promise and deferred. The portion of the payment allocated to an option is based on its stand-alone selling price, which is typically determined by the discount the customer receives and the likelihood the customer will exercise the option (see paragraph 23A.11). These two factors are often linked: the greater the discount, the more likely customers are to exercise the option.

If the discount the customer receives compared with the normal selling price for the good or service is significant, and there is a high likelihood that customers will exercise the option, the portion of the payment allocated to the option would be significant. In such cases, the benefits of the information provided to users by accounting for the option as a separate promise would be expected to exceed the costs or effort of doing so.

Assessing whether accounting for an option will involve undue cost or effort—Cost or effort to entity

To account for an option as a separate promise, an entity needs to record when the option is first granted and monitor whether the option is redeemed or expires. Whether an entity collects this information will depend on the nature and type of the option. For example, an entity would be likely to have systems and processes that collect this information if operating a popular customer loyalty programme. However, an entity would be less likely to have systems and processes that collect this information if issuing vouchers for low-value discounts redeemable over a short timeframe.

If an entity already has, or could easily and inexpensively collect, the information needed to account for an option as a separate promise, the incremental cost and additional effort of doing so would be insignificant. In such cases, the benefits of the information provided to users by accounting for the option as a separate promise would be expected to exceed the costs or effort of doing so.

Example—Criteria in paragraph 23A.9(a) met (discount voucher)

Ex 116 An SME awards customers who purchase goods on a particular day a voucher for 25% off their next purchase. Customers must redeem the voucher within three months. The SME does not offer its customers any other discounts throughout the year.

Because the SME does not offer its customers any other discounts throughout the year, the voucher grants customers a material right that:

- is only available to a customer that has entered into a contract with the SME on a particular day (paragraph 23A.9(a)(i)); and
- allows a customer to acquire goods at a discount to their stand-alone selling price (paragraph 23A.9(a)(ii)).

Therefore, the criteria in paragraph 23A.9(a) are met.

Example—Criteria in paragraph 23A.9(a) not met (discount voucher)

Ex 117 The facts are the same as in Example 116. However, in this example, the SME regularly runs promotions where all goods are sold with a 40% discount.

Because the SME regularly offers new customers a 40% discount, the voucher does not grant customers a material right that is only available to customers that have entered into a contract with the SME on a particular day (paragraph 23A.9(a)(i)).

Therefore, the criterion in paragraph 23A.9(a)(i) is not met and the SME does not account for the option as a separate promise.

Example—Criteria in paragraph 23A.9(a) met (sales incentive)

Ex 118 An SME sells wood burning stoves. For four months after purchasing a stove, a customer can buy wood from the SME for CU10 a bag. The SME usually sells wood for CU20 a bag.

The SME grants customers a material right that:

- is only available to customers that have bought a stove (paragraph 23A.9(a)(i)); and
- allows customers to acquire a bag of wood at a discount to its stand-alone selling price (paragraph 23A.9(a)(ii)).

Therefore, the SME concludes that the criteria in paragraph 23A.9(a) are met.

Example—Criteria in paragraph 23A.9(a) not met (sales incentive)

Ex 119 The facts are the same as in Example 118. However, in this example, the SME only sells wood to customers that have purchased a stove. A competitor of the SME also sells wood from the same supplier for CU8 a bag.

Because customers could purchase a bag of wood at a lower price, the option does not give customers a material right that allows them to acquire an additional good at a discount to its stand-alone selling price (paragraph 23A.9(a)(ii)).

Therefore, the SME concludes that the criterion in paragraph 23A.9(a)(ii) is not met and does not account for the option as a separate promise.

Example—Criterion in paragraph 23A.9(b) met (loyalty points programme)

Ex 120 An SME runs a chain of health food shops. The SME has a loyalty programme in which customers accumulate one point for every CU10 spent. Each point is redeemable for a CU1 discount on any future purchases made from the SME's shops. To administer the programme, the SME records information about the number of points each customer has earned and redeemed. Historically, around 75% of loyalty points are redeemed.

The SME concludes that the criteria in paragraph 23A.9(a) are met.

The SME determines that the benefits to users of its financial statements of the information from accounting for the options as separate promises would exceed any further costs or effort by the SME. The SME's decision is based on:

- the popularity of the loyalty programme and value of the discount to customers, which means there is a high volume of points redeemed and the amount of consideration allocated to the options would be significant; and
- the SME's existing system for tracking loyalty programme activity, which means the additional cost or effort to account for the options separately is insignificant.

Therefore, the SME concludes that the criterion in paragraph 23A.9(b) is met and accounts for the options as separate promises.

Example—Criterion in paragraph 23A.9(b) not met ('buy six and get one free' loyalty scheme)

Ex 121 **An SME runs a chain of roadside service stations where customers can get their cars washed. The SME has a loyalty scheme where customers who have had their car washed six times can get their car washed for free. The scheme is administered using a stamp card, where customers receive a stamp each time their car is washed. The SME does not track when customers are awarded stamps or redeem free car washes. Experience has shown that very few free car washes are redeemed, because customers either do not frequently return to the service stations or lose or forget their stamp cards.**

The SME concludes that the criteria in paragraph 23A.9(a) are met.

The SME determines that the incremental costs and additional effort of accounting for the option as a separate promise would exceed the benefits to users of its financial statements of the information from doing so. The SME's decision is based on:

- the low likelihood that customers redeem free car washes, which means the amount of consideration allocated to the option would be insignificant; and
- the SME having no system to track when stamps are awarded or redeemed, which means the additional cost or effort to account for the options separately is significant.

Therefore, the SME concludes that the criterion in paragraph 23A.9(b) is not met and does not account for the option as a separate promise.

23A.10 To account for the option as a separate promise, the entity shall:

(a) allocate a portion of the transaction price to the promise (see paragraphs 23A.11–23A.13); and

(b) recognise revenue when the entity transfers those future goods or services or when the option expires.

23A.11 In accordance with Step 4, an entity shall allocate the transaction price to each promise in the contract on a relative stand-alone selling price basis. If the stand-alone selling price is not directly observable, an entity shall estimate the price. The estimate of the stand-alone selling price of an option shall reflect the discount that the customer would obtain when exercising the option, adjusted for:

(a) any discount that the customer could receive without exercising the option; and

(b) the likelihood that the customer exercises the option.

Educational notes

To account for an option to acquire additional goods or services as a separate promise, an entity is required to determine what portion of the transaction price to allocate to the promise, and when to recognise that amount as revenue.

What portion of the transaction price an entity allocates to the promise is covered in paragraph 23A.11 (and paragraphs 23A.12–23A.13 for renewal options). This portion can be difficult for an entity to calculate because the stand-alone selling price of an option is not usually observable. This is because it is uncommon for an entity to sell an option separately that it grants to customers that have made an earlier purchase. Therefore, an entity will usually need to estimate the stand-alone selling price of the option.

When an entity recognises revenue is covered in paragraph 23A.10(b). This is usually easy for an entity to identify if it records when options are redeemed and expire.

Estimating the stand-alone selling price of an option

The starting point for estimating the stand-alone selling price of an option is the value of the discount if the customer exercised the option (that is, the selling price of the additional good or service multiplied by the discount). For additional goods or services that a customer can acquire for free, this will be the selling price of the goods or services. The entity then adjusts the value of the discount for the factors in paragraph 23A.11:

- *any discount that the customer could receive without exercising the option* (paragraph 23A.11(a))—these would be any other discounts that the entity is offering to new customers at the same time the option can be exercised.
- *the likelihood that the customer exercises the option* (paragraph 23A.11(b))—this would be expected to be based on the redemption rate for similar options or past experience with the same options.

Paragraph 23.42 does not permit an entity to reallocate the transaction price to reflect changes in the stand-alone selling prices after the start of the contract. Therefore, an entity would not change the amount of consideration allocated to an option if the entity's expectations about the likelihood of the customer exercising the option change after the start of the contract.

Example—Accounting for option as separate promise (discount voucher)

Ex 122 An SME awards customers who purchase goods on a particular day a voucher for 40% off their next purchase. Customers must redeem the voucher within three months. The SME does not offer its customers any other discounts throughout the year.

A customer purchases goods for CU96 and is awarded a voucher.

The SME concludes that the criteria in paragraph 23A.9 are met and accounts for the option as a separate promise.

Because the SME does not separately sell the vouchers, it estimates the voucher's stand-alone selling price.

The SME estimates that 75% of customers will redeem the voucher and that a customer will, on average, purchase CU80 of goods when doing so.

The SME estimates the voucher's stand-alone selling price as CU24 (CU80 average purchase price of additional goods × 40% discount × 75% likelihood of exercising the option). Therefore, the SME determines the stand-alone selling prices of the goods and voucher awarded to the customer in the contract as follows:

Promise	Stand-alone selling price
	CU
Goods	96
Voucher	24
Total	120

The SME allocates the transaction price of CU96 proportionately between the goods and the voucher on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Goods	76.8	CU96 × (CU96 ÷ CU120)
Voucher	19.2	CU96 × (CU24 ÷ CU120)
Total	96.0	

When the customer purchases the goods, the SME recognises CU76.8 as revenue and CU19.2 as a contract liability. The SME recognises CU19.2 as revenue when the customer redeems the voucher or when it expires.

Example—Accounting for option as separate promise (sales incentive)

Ex 123 An SME sells wood burning stoves. For four months after purchasing a stove, a customer can buy wood from the SME for CU10 a bag. The SME usually sells wood for CU20 a bag.

A customer purchases a wood burning stove for CU108.

The SME concludes that the criteria in paragraph 23A.9 are met and accounts for the option as a separate promise.

Because the SME does not separately sell the option to purchase wood at a 50% discount, it estimates the option's stand-alone selling price.

The SME estimates 80% of customers who buy a stove will then purchase wood at CU10 a bag. It also estimates that these customers will, on average, purchase three bags of wood over the next four months. Over the next four months, the SME intends to run a seasonal promotion and discount bags of wood by 5%. The discount will not apply to the discounted price of CU10 a bag. Therefore, the SME is offering customers that have bought a stove an incremental discount of 45% over the next four months (that is, a 45% discount in addition to the 5% discount awarded to new customers).

The SME estimates the option's stand-alone selling price as CU21.6 (CU60 (CU20 × 3) average purchase price of additional goods × 45% incremental discount × 80% likelihood of exercising the option). Therefore, the SME determines the stand-alone selling prices of the stove and option in the contract as follows:

Promise	Stand-alone selling price
	CU
Stove	108.0
Option	21.6
Total	129.6

The SME allocates the transaction price of CU108 proportionately between the stove and the option on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Stove	90	CU108 × (CU108 ÷ CU129.6)
Option	18	CU108 × (CU21.6 ÷ CU129.6)
Total	108	

When the customer purchases the goods, the SME recognises CU90 as revenue and CU18 as a contract liability. The SME recognises CU18 as revenue as the customer purchases the wood over the next four months.

Example—Accounting for options as separate promises (loyalty points programme)

Ex 124 An SME runs a chain of health food shops. The SME has a loyalty programme in which customers accumulate one point for every CU10 spent. Each point is redeemable for a CU1 discount on any future purchases made from the SME's shops. To administer the programme, the SME records information about the number of points each customer has earned and redeemed. Historically, around 75% of loyalty points are redeemed.

During the year, customers who are members of the programme make purchases of CU860,000 and earn 86,000 points.

By the end of the year, 43,000 points have been redeemed.

The SME concludes that the criteria in paragraph 23A.9 are met and accounts for the option as a separate promise.

Because the SME does not separately sell loyalty points, it estimates the points' stand-alone selling price.

The SME estimates that 84% of the points earned will be redeemed on future purchases.

The SME estimates the stand-alone selling price of points as CU72,240 (CU1 value of the discount per point × 86,000 number of points earned × 84% likelihood of exercising the points). Therefore, the SME determines the stand-alone selling price of the goods and points as follows:

Promise	Stand-alone selling price
	CU
Goods	860,000
Points	72,240
Total	932,240

The SME allocates the transaction price of CU860,000 proportionately between the stove and the option on a relative stand-alone selling price basis as follows:

Promise	Allocated transaction price	Calculation
	CU	
Goods	793,358	CU860,000 × (CU860,000 ÷ CU932,240)
Points	66,642	CU860,000 × (CU72,240 ÷ CU932,240)
Total	860,000	

At the reporting date, the SME's financial statements include:

- revenue of CU793,358 for sales to members of the programme;
- revenue of CU33,321 for points redeemed by members of the programme during the year (CU66,642 × (43,000 ÷ 86,000)); and
- a contract liability of CU33,321 (CU66,642 – CU33,321) for unredeemed points.

23A.12 An entity might grant a customer an option to renew a contract on similar terms. If the entity accounts for the renewal option as a separate promise, it shall allocate the transaction price to the option based on the total expected consideration allocated to the total goods or services it expects to transfer, instead of estimating the stand-alone selling price of the option. The entity shall include expected renewal period(s) when estimating the total goods or services it expects to transfer and corresponding total expected consideration.

23A.13 The amount of the transaction price allocated to the renewal option is the difference between:

(a) the transaction price for the original contract; and

(b) the amount of the total expected consideration allocated to the goods or services to be transferred under the original contract.

Educational notes

Entities with subscription or membership-based business models often grant customers options to renew contracts on similar terms. For example, options granted to members of gyms or subscribers of publications to renew their existing contracts. Such renewal options often provide a customer with an option to acquire the same goods or services as those being provided under the existing contract, but at a discount to their stand-alone selling price (meeting the criterion in paragraph 23A.9(a)(ii)). This could be done by:

- not charging upfront fees that are ordinarily charged to new customers (for example, waiving joining fees for customers that renew); or
- not raising prices for customers that renew (for example, allowing customers to renew at their original price, but increasing the price charged to new customers).

An entity applies paragraphs 23A.9–23A.10 to determine whether an entity is required to account for a renewal option as a separate promise. If the renewal option is accounted for as a separate promise, the entity then applies paragraphs 23A.12–23A.13 to allocate the transaction price to the option, instead of estimating the option's relative stand-alone selling price.

The method for allocating the transaction price to the renewal option in paragraphs 23A.12–23A.13 requires an entity:

- *to estimate the total expected consideration for the contract*—to estimate this amount, the entity judges whether, and how often, a customer will renew the contract. This is different from the requirements for estimating the transaction price in Step 3 of the model, where an entity does not factor in whether the contract will be renewed.

- *to allocate the total expected consideration to the goods or services to be transferred under the original contract*—the Standard does not specify how to allocate this amount. An entity could allocate the amount on the basis of the stand-alone selling prices of the goods or services in the contract (see Example 128), or using another basis, such as costs. Often the stand-alone selling prices of the goods or services in the contract will be the same, unless the entity charges different prices for customers that renew.

Paragraph 23A.10(b) requires an entity to recognise the portion of the transaction price that was allocated to an option as revenue when the entity transfers the future goods or services or when the option expires. However, the Standard does not specify how an entity is required to allocate the portion of the transaction price relating to the renewal option between renewal periods. Therefore, the management of an entity is required, in accordance with paragraph 10.4, to use its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable.

One method would be to allocate the portion of the transaction price equally between the expected renewal periods. Doing so would result in the entity recognising the portion of the transaction price as revenue on a straight-line basis over the expected renewal periods.

An alternative method would be to recalculate the portion of the transaction price allocated to the renewal option at each reporting date. The difference between these amounts would be recognised as revenue. This method would factor in any changes in the value of the renewal option to the customer as the contract progresses. For example, if a renewal option allows a customer to renew at their original price, but the price charged to new customers increases, the value of the option to the customer will increase as the difference between the original price and the price charged to new customers widens.

Examples—Criteria in paragraph 23A.9 (renewal option)

Ex 125 The facts are the same as in Example 15. That is, an SME enters into a contract with a customer for one year of transaction processing services. The SME charges the customer an upfront fee for setting up the customer on the SME's systems and processes. The fee is non-refundable. The SME's set-up activities do not transfer a good or service to the customer.

However, in this example, the SME gives customers the option to renew the contract without paying the upfront fee.

The SME grants the customer a material right that:

- is only available to a customer that has entered into an existing service contract (paragraph 23A.9(a)(i)); and
- allows the customer to acquire the same service without paying an upfront fee, therefore granting a discount to the stand-alone selling price of the service (paragraph 23A.9(a)(ii)).

Therefore, the criteria in paragraph 23A.9(a) are met.

Ex 126 An SME enters into contracts with customers for a subscription that allows them to access online material. The SME charges CU350 for the first year of the subscription. The SME offers to charge customers CU350 per year for the next three years if they renew the contract at the end of each year.

The SME typically increases the amount it charges to customers by 10% each year. Therefore, customers will save by renewing the contract at the end of the first, second or third years.

The SME records information about the renewal options granted and redeemed by customers. When the SME has offered customers the option to renew at the original price, the majority of customers have done so.

The SME grants the customer a material right that:

- is only available to a customer that has an existing subscription (paragraph 23A.9(a)(i)); and
- allows a customer to acquire an additional year's subscription at a discount to its stand-alone selling price (paragraph 23A.9(a)(ii)).

Therefore, the criteria in paragraph 23A.9(a) are met.

The SME determines that the benefits to users of its financial statements of the information from accounting for the option as a separate promise would exceed any further costs or effort by the SME. The SME's decision is based on:

- the popularity of the offer and value of the discounted price to customers, which means the amount of consideration allocated to the option would be significant; and
- the SME's existing system for tracking customer renewals, which means the additional cost or effort to account for the options separately is insignificant.

Therefore, the SME concludes that the criteria in paragraph 23A.9(b) are met and accounts for the options as separate promises.

Examples—Accounting for renewal option as a separate promise

Ex 127 An SME runs a sports club. The SME charges customers that join the club a CU500 joining fee and CU1,200 for annual membership. The joining fee is non-refundable and does not transfer a good or service to the customer.

The SME offers customers the option to pay CU1,200 at the end of each year to rejoin the club for another year without having to pay a joining fee.

The SME concludes that the criteria in paragraph 23A.9 are met and accounts for the renewal option as a separate promise.

The SME expects customers to renew their membership four times on average, and therefore to remain members for five years. It estimates the total expected consideration for each contract as CU6,500 (CU500 + (5 × CU1,200)).

The SME allocates the transaction price of CU1,700 (CU500 joining fee + CU1,200 annual membership) between the membership and renewal option.

The amount of the transaction price allocated to the renewal option is CU400, being the difference between:

- the transaction price for the contract (CU1,700); and
- the total expected consideration allocated to the first year of the contract based on the number of years of service to be provided (CU6,500 ÷ 5 years = CU1,300). The SME allocates the total expected consideration using the number of years of service because the stand-alone selling price of each year of service is the same.

The remaining CU1,300 is allocated to Year 1 of the membership (CU1,700 – CU400).

The reporting period and membership year are the same. At the end of Year 1, the SME recognises revenue of CU1,300 and a contract liability of CU400.

The CU400 allocated to the renewal option would be recognised as revenue over each renewal period. Because the Standard does not specify a method for doing so, the management of the SME uses its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable. One method would be to recognise the amount on a straight-line basis (that is, recognise CU100 each year in addition to the amount the customer pays each year for membership).

Ex 128 The facts are the same as in Example 126.

At the beginning of the first year, 100 customers enter into a contract for a subscription. The SME expects 80 customers to renew for a second year, 65 customers to renew for a third year and 50 customers to renew for a fourth year. The SME estimates the total expected consideration as follows:

Year	Number of customers	Price	Expected consideration
		CU	CU
Year 1	100	350	35,000
Year 2	80	350	28,000
Year 3	65	350	22,750
Year 4	50	350	17,500
		Total	103,250

The stand-alone selling price for each year of the contract is the amount charged to new customers. Because the SME expects to increase the amount it charges to customers by 10% each year (see Example 126), the SME calculates the stand-alone selling price as follows:

Year	Number of customers	Stand-alone selling price	Total stand-alone selling price
		CU	CU
Year 1	100	350	35,000
Year 2	80	385	30,800
Year 3	65	424	27,560
Year 4	50	466	23,300
		Total	116,660

The SME allocates the transaction price of CU35,000 (CU350 × 100 customers) between the subscription and renewal option.

The amount of the transaction price allocated to the renewal option is CU4,023, being the difference between:

- the transaction price for the contract (CU35,000); and
- the total expected consideration allocated to Year 1 of the contract based on the stand-alone selling price of each year of the contract (CU103,250 × (CU35,000 ÷ CU116,660) = CU30,977).

The remaining CU30,977 is allocated to the subscription (CU35,000 – CU4,023).

Assuming there is no change in the SME's expectations and the reporting period and membership year are the same, the SME recognises revenue of CU30,977 and a contract liability of CU4,023 at the end of Year 1.

The CU4,023 allocated to the renewal option would be recognised as revenue over the remaining three renewal periods. Because the Standard does not specify a method for doing so, the management of the SME uses its judgement in developing and applying an accounting policy that results in information that is relevant to the economic decision-making needs of users and is reliable.

One method would be to recognise the amount on a straight-line basis (that is, CU1,341 in Years 2–4).

An alternative method would be to calculate the transaction price for the contract for Year 1 and Year 2 and allocate that amount between the subscription and option. The amount allocated to the option for Year 2 would be CU4,764, the difference between:

- the transaction price for Year 1 and Year 2 (CU35,000 + CU28,000 = CU63,000); and
- the total expected consideration allocated to Year 1 and Year 2 of the contract based on the stand-alone selling price of each year of the contract (CU103,250 × ((CU35,000 + CU30,800) ÷ CU116,660) = CU58,236).

If CU4,764 was allocated to the option at the end of Year 2, the SME would recognise CU741 (CU4,764 – CU4,023) of the consideration received in Year 2 as a contract liability and CU27,259 (CU28,000 – CU741) as revenue.

A similar calculation would be required for Year 3.

The alternative method requires the SME to allocate a portion of the consideration received in Year 2 to the renewal option. This reflects that the value of the renewal option increases during the contract as the difference between the amount charged to existing and new customers increases. Because the value of the renewal options in Year 3 and Year 4 is greater than the value of the renewal options in Year 1 and Year 2, a portion of the consideration paid by a customer in Year 1 and Year 2 represents advance payment for the subscription in Year 3 and Year 4.

Principal versus agent considerations

23A.14 If another party is involved in providing goods or services to a customer, an entity shall determine whether its promise is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for the other party to provide those goods or services (that is, the entity is an agent).

Educational notes

The requirements for principal versus agent considerations relate to Step 2 of the revenue recognition model. The requirements determine the nature of the entity's promise and whether it recognises revenue on a gross basis (as a principal) or a net basis (as an agent).

The requirements apply if another party is involved in providing goods or services to a customer. If an entity transfers control of a good or service directly to its customers, without the involvement of another party, the requirements do not apply.

Example—Requirements for principal versus agent considerations do not apply

Ex 129 An SME manufactures goods that it transfers to a retailer. The retailer then sells the goods to customers.

The SME's customer is the retailer, not the customers that purchase the goods from the retailer.

Because the SME transfers control of the goods directly to the retailer without the involvement of another party, the requirements for principal versus agent considerations do not apply.

The SME recognises revenue at the amount it is entitled to for transferring the goods to the retailer.

23A.15 To determine whether an entity is a principal or agent, the entity shall:

(a) identify the specified goods or services to be provided to the customer (see paragraph 23A.16); and

(b) evaluate whether it controls each specified good or service before that good or service is transferred to the customer (see paragraph 23A.18).

Educational notes

Paragraph 23A.15 gives an overview of the steps an entity needs to follow to determine whether it is a principal or agent.

The requirements apply to each specified good or service in the contract.

In a contract, an entity might determine that it is acting as principal for some specified goods or services, and an agent for others.

An example is a retailer that enters into a contract to sell a car with an extended warranty. If the car is distinct from the warranty in accordance with paragraphs 23A.5–23A.7, the retailer would have to determine whether it is a principal or agent for:

- the sale of the car; and
- the sale of the extended warranty.

In such a contract, it would be possible for the entity to be the principal for the sale of the car, and the agent for the sale of the extended warranty, as illustrated in Example 114.

23A.16 A specified good or service is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. A right to a future service to be provided by another party might be a distinct good or service (for example, a ticket that gives the customer the right to fly on a specified flight).

Educational notes

The requirements for principal versus agent considerations refer to the 'specified good or service … to be provided to the customer'. This is different from the rest of the Section, which refers to promises, which are fulfilled when (or as) an entity transfers distinct goods or services to a customer.

The terminology used in the requirements for principal versus agent considerations accommodates contracts where an entity is the agent. An agent arranges for goods or services to be provided to the customer by the principal; the agent does not provide the goods or services to the customer itself. Therefore, if an entity is an agent, referring to a promise to transfer goods or services could be confusing because the agent does not provide any goods or services to the customer itself.

Although the requirements do not use the term promise, only a good or service that is distinct can be a specified good or service. Therefore, an entity would be expected to apply paragraphs 23.18–23.22 to identify the distinct goods or services in a contract, and the specified goods or services to be provided to the customer.

Identifying the specified goods or services requires the entity to assess what good or service the customer receives by entering into the contract. This will either be:

- goods or services; or
- the right to goods or services in the future.

In some contracts, it can be difficult to distinguish whether a customer receives a good or service, or a right to a good or service. However, this distinction is important because it can change an entity's assessment of whether it is a principal or agent. For example, in a contract to transfer an airline ticket, the customer receives the right to the flight (that is, a right to a service to be provided by the airline in the future). Purchasing the ticket does not provide the customer with the flight itself (that is, the underlying service). Therefore, the entity's assessment of whether the entity is acting as a principal or agent is based on who controls the right to the flight before it transfers to the customer.

Examples—Identifying specified goods or services

Ex 130 An SME operates a gallery that sells artwork created by local artists.

Each artwork sold by the SME is distinct.

By entering into a contract with the SME, a customer receives an item of artwork. Therefore, the specified good or service is an item of artwork.

Ex 131 An SME runs a website that sells vouchers that entitle customers to a meal at a specified restaurant. The sales price of the voucher provides customers with a significant discount when compared with the normal selling price of the meals (for example, a customer pays CU100 for a voucher that entitles the customer to a meal at a restaurant that would otherwise cost CU200).

Each voucher sold by the SME is distinct.

By entering into a contract with the SME, a customer receives a voucher. Therefore, the specified good or service is a right to a meal in the future provided by a restaurant—the voucher.

Ex 132 An SME provides vehicle maintenance services. The SME engages third-party service providers to provide the maintenance services.

The SME sells no services other than maintenance services. Therefore, the maintenance services sold by the SME are distinct.

By entering into a contract with the SME, a customer receives maintenance services. Therefore, the specified good or service is the maintenance services.

23A.17 An entity is a principal if it controls the specified good or service before that good or service is transferred to the customer.

23A.18 An entity has control of a specified good or service if it has the present ability to direct the use of that good or service and obtain the economic benefits that might flow from it. Indicators that the entity controls the specified good or service before it is transferred to a customer (and is therefore a principal) include:

(a) the entity being primarily responsible for fulfilling the promise to transfer the specified good or service. This responsibility typically includes responsibility for the acceptability of the specified good or service.

(b) the entity having inventory risk before or after the specified good or service is transferred to the customer (for example, if the entity commits to obtaining the good or service before it is sold or accepts responsibility for damaged or returned goods).

(c) the entity having discretion to set the price for the specified good or service.

Educational notes

An entity's assessment of whether it controls the specified goods or services before they transfer to the customer determines whether it is a principal or agent. For some contracts, this assessment will be straightforward, but for others the entity will need to look carefully for the indicators of control in paragraph 23A.18.

If the indicators of control do not all lead to the same conclusion, the entity will need to make an overall judgement based on all of the information available. This will include whether some of the indicators are more or less relevant to the assessment of control depending on the nature of the specified good or service and the terms and conditions of the contract.

Primary responsibility for fulfilling the promise (paragraph 23A.18(a))

If the entity is primarily responsible for fulfilling the promise to the customer, this suggests that any other party in the contract is simply acting on the entity's behalf.

Inventory risk (paragraph 23A.18(b))

If the entity obtains the good or service before it is sold to the customer, this suggests that the entity could direct the use of, and obtain the remaining benefits that might flow from, the good or service before it transfers to the customer. Similarly, if the entity has the responsibility to replace or refund goods that are damaged when they reach the customer, this suggests that the entity controls the good before it transfers to the customer.

Discretion to set the price (paragraph 23A.18(c))

If the entity has the discretion to set the price to the end customer, this suggests that it controls the good or service before it is transferred. However, this is not always the case: sometimes a principal permits an agent to make decisions on pricing, perhaps within pre-agreed parameters.

Examples—Determining whether an entity is principal or agent

Ex 133 The facts are the same as in Example 130.

The artworks are stored in the gallery and sold and delivered by the SME. The price charged to the customer is set by the artist, not the SME. If an item of artwork is not sold by the SME within six months, it is returned to the artist.

The specified good or service is the item of artwork (see Example 130).

The SME concludes that it does not control the artwork before it is transferred to the customer. This conclusion is supported by the indicators in paragraphs 23A.18(b)–(c):

- the SME does not have inventory risk because any unsold artwork is returned to the artist; and
- the SME does not have any discretion in setting the price of the artwork.

Consequently, the SME is an agent and its promise is to arrange the sale of artwork.

Ex 134 The facts are the same as in Example 131.

The SME purchases the vouchers from the restaurant when the customer requests the vouchers. The SME does not purchase or commit itself to purchase vouchers in advance of the sale of a voucher to a customer.

The vouchers are non-refundable, and their selling prices are determined jointly between the SME and the restaurant.

The restaurant is responsible for fulfilling the voucher (that is, providing the meal), including dealing with any dissatisfied customers.

The specified good or service is a right to a meal in the future provided by a restaurant—the voucher (see Example 131).

The SME concludes that it does not control the voucher before it is transferred to the customer. This is because the vouchers only exist when they transfer to the customer and do not exist before that transfer. Therefore, the SME does not have any ability to direct the use of the voucher, or obtain the economic benefits that might flow from it. This conclusion is supported by the indicator in paragraph 23A.18(b):

- the SME does not have inventory risk because it neither purchases, nor commits itself to purchase, vouchers before they are sold to customers. The SME also has no responsibility to accept returned vouchers.

Consequently, the SME is an agent and its promise is to arrange the sale of vouchers.

Ex 135 The facts are the same as in Example 132.

The SME and customer determine the nature of the vehicle maintenance services and negotiate their price. It is the SME's responsibility to ensure the services are performed in accordance with the terms and conditions of the contract.

The third-party service providers that the SME engages to provide the maintenance services are contracted only after the SME's contract with the customer is agreed. The SME must pay the service providers regardless of whether the customer has paid.

The specified good or service is the maintenance services (see Example 132).

The SME concludes that it controls the maintenance services before they are transferred to the customer. This conclusion is supported by the indicators in paragraph 23A.18(a) and (c):

- the SME is primarily responsible for fulfilling the promise to transfer the maintenance services. Although the SME does not provide the maintenance services itself, the SME has responsibility for ensuring the services are performed and are acceptable to the customer.
- the SME has discretion in setting the price for the maintenance services.

The SME does not have inventory risk because it engages service providers only once it has entered into a contract with a customer. However, the SME's lack of inventory risk is considered to be outweighed by evidence from the other indicators.

Consequently, the SME is a principal and its promise is to transfer maintenance services.

23A.19 A principal shall recognise as revenue the gross amount of the consideration it expects to be entitled to in exchange for transferring the specified good or service when (or as) it transfers control of that good or service to the customer.

Educational notes

If an entity is a principal in a transaction, it recognises revenue on a gross basis. Therefore, the entity recognises the full amount of consideration it expects to be entitled to as revenue. The entity makes no adjustments for consideration that it pays to:

- an agent for arranging the sale; or
- a third party for providing the specified goods or services to the customer.

Such consideration will be recognised as an expense in the income statement or an asset in the statement of financial position in accordance with applicable requirements. Consequently, it does not affect the amount of revenue an entity recognises.

Examples—Recognising revenue as principal

Ex 136 The facts are the same as in Examples 132 and 135.

The SME enters into a contract to provide a year of vehicle maintenance services for CU1,800.

The services are provided to the customer by a third-party service provider to whom the SME pays CU1,500.

The SME is a principal and its promise is to transfer vehicle maintenance services (see Example 135). The promise is fulfilled over time.

The SME recognises revenue of CU1,800 as it fulfils its promise to transfer the vehicle maintenance services.

The costs of fulfilling the contract (the costs of the third-party service provider) are recognised as an expense as they are incurred because they do not meet the criteria in paragraph 23.70.

Ex 137 An SME sells an item of second-hand furniture to a customer through an online marketplace for CU500.

The customer pays the marketplace CU500, who then pays the SME CU400. The difference of CU100 (CU500 – CU400) is a fee charged by the marketplace for the SME having sold the furniture on its website.

The SME is a principal and its promise is to provide furniture to the customer. The promise is fulfilled at a point in time.

The SME recognises revenue of CU500 when it fulfils its promise to transfer the furniture to the customer.

The CU100 charged by the marketplace is a cost of obtaining the contract and is recognised as an expense as it is incurred in accordance with paragraph 23.68.

23A.20 An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. An agent shall recognise as revenue the amount of the fee or commission it expects to be entitled to in exchange for arranging for another party to provide the specified good or service as the agent fulfils its promise to arrange the transfer of that good or service.

Educational notes

In some contracts, the agent arranges for another party to provide a specified good or service to a customer and also collects the consideration from the customer. The consideration is then paid to the principal, net of the agent's fee or commission for its service of arranging the sale (that is, the agent's revenue). In such instances, the agent recognises revenue on a net basis.

An agent's revenue might be a percentage of the sales value of the specified goods or services (for example, sales commission—see Example 138) or a fixed fee for each sale arranged (see Example 27).

Example—Recognising revenue as agent

Ex 138 The facts are the same as in Examples 130 and 133.

The SME enters into a contract to sell an item of artwork for CU800. The SME charges the artist sales commission of 40% (CU800 × 40% = CU320), which it deducts from the amount of consideration collected from the customer.

The SME is an agent and its promise is to arrange the sale of artwork (see Example 133). The promise is fulfilled at a point in time.

The SME recognises revenue of CU320 when it fulfils its promise to arrange the sale of artwork.

Non-cash consideration

23A.21 The consideration promised by a customer might be in a form other than cash, such as goods or services. An example is an exchange of goods in a barter transaction.

23A.22 An entity shall measure the non-cash consideration at **fair value** unless the fair value cannot be reasonably estimated. If the entity cannot reasonably estimate the fair value of the non-cash consideration, the entity shall instead measure the consideration based on the stand-alone selling price of the goods or services promised to the customer in exchange for the consideration.

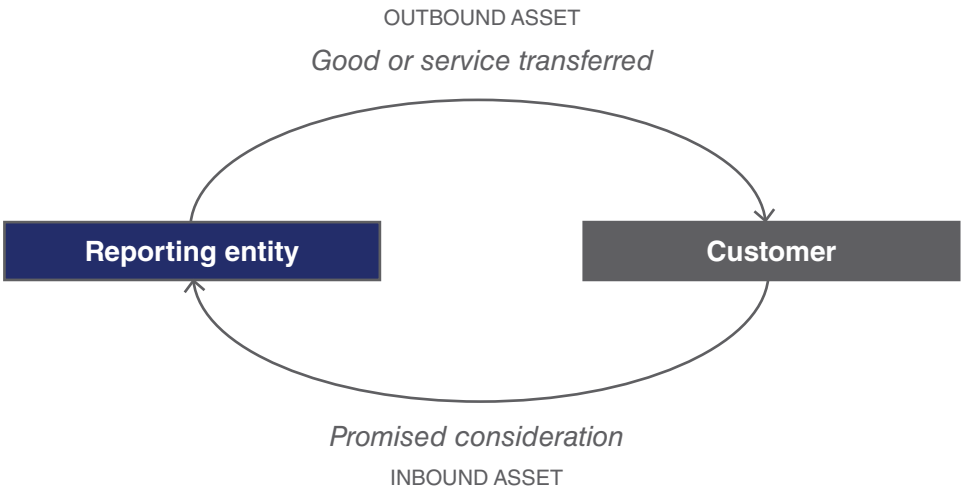
Educational notes

The requirements for non-cash consideration relate to Step 3 of the revenue recognition model.

Figure 26 shows the 'outbound assets' and 'inbound assets' in a contract with a customer. Typically, the inbound asset promised by a customer is cash. However, the requirements for non-cash consideration would apply if the inbound asset were in a form other than cash. The inbound asset could be:

- a good or service;
- an item of property, plant and equipment; or
- a financial instrument (for example, shares issued by the customer).

Figure 26—Inbound and outbound assets in a contract with a customer



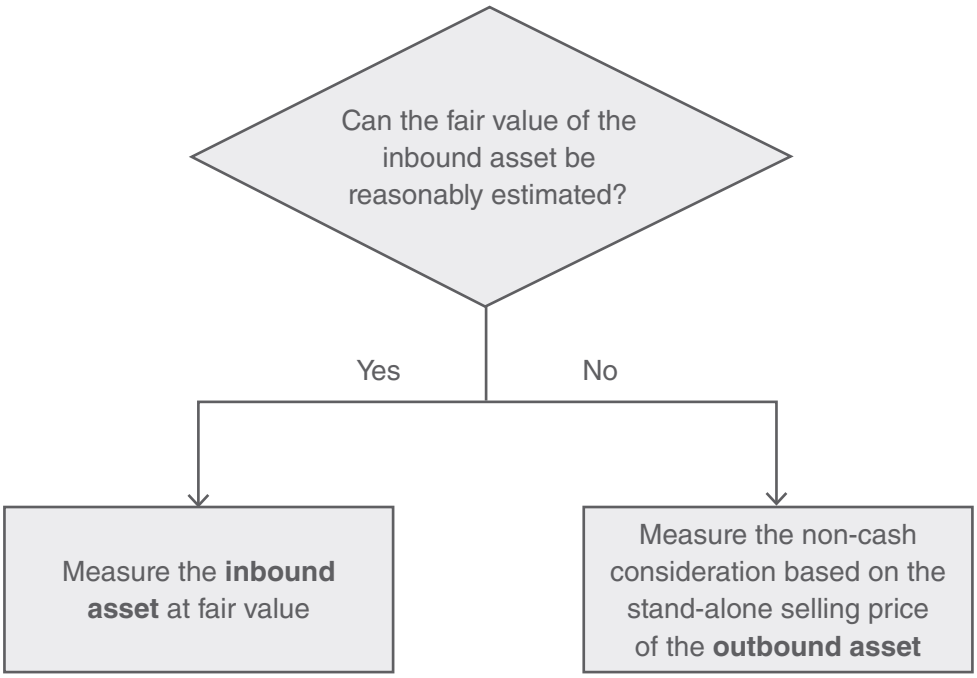
Non-cash transactions excluded by paragraph 23.1(d)

Paragraph 23.1(d) excludes from Section 23 non-cash exchanges of products between entities in the same line of business to help make sales to customers. Therefore, if the inbound asset is products to be sold to the reporting entity's customers, and the outbound asset is products to be sold to the other entity's customers, paragraphs 23A.21–23A.22 would not apply (for example, an exchange of petrol and diesel between fuel retailers to fulfil customer demand—see Example 2).

Measurement of non-cash consideration

The requirements for measuring non-cash consideration are summarised in Figure 27.

Figure 27—Measuring non-cash consideration



Whether an entity can reasonably estimate the fair value of the inbound asset will depend on its form and the information available to the entity to measure its fair value. Section 12 *Fair Value Measurement* provides guidance on fair value measurement.

If an entity cannot reasonably estimate the fair value of the inbound asset, the entity measures the stand-alone selling price of the outbound asset. Paragraphs 23.42–23.44 cover how an entity measures the stand-alone selling price of a good or service.

Step 3 includes specific requirements on variable consideration and deferred payment. These requirements apply whether the amount promised by the customer is in the form of cash or non-cash consideration.

Subsequent accounting

After measuring the non-cash consideration in accordance with Section 23, an entity accounts for the non-cash consideration received (or receivable) by applying the relevant section of the Standard (for example, Section 11 *Financial Instruments*, Section 13 *Inventories* or Section 17 *Property, Plant and Equipment*). The entity would apply the requirements in the relevant section of the Standard once the asset arising from the non-cash consideration is recognised.

Example—Fair value of non-cash consideration can be reasonably estimated

Ex 139 An SME normally sells Product A for CU550 per unit.

The SME exchanges 10 units of Product A for 10 hours of accounting services from an accounting firm. The services are available to the firm's clients at CU500 per hour. Each unit is accounted for as a separate promise fulfilled at a point in time.

The SME has information about the market price of the non-cash consideration (that is, the accounting services promised by the accounting firm). Therefore, the SME determines that it can reasonably estimate the fair value of the non-cash consideration.

The SME uses the market approach to estimate the fair value of the non-cash consideration at CU5,000 (10 hours of accounting services × CU500 per hour). It recognises revenue of CU500 when it transfers each product to the customer (CU5,000 ÷ 10 units).

Example—Fair value of non-cash consideration cannot be reasonably estimated

Ex 140 An SME runs a car dealership. The SME sells a car to a customer which has a retail selling price of CU1,000. In exchange for the car, the customer agrees to provide the SME with advertising space on the side of its office near a new road. Because the advertising space is near a new road, there is no other advertising space nearby and it is difficult to estimate the fair value of the advertising space promised by the customer. The car is accounted for as a single promise fulfilled at a point in time.

The lack of information the SME has about the value of the non-cash consideration (that is, the advertising space promised by the customer) means the SME cannot reasonably estimate the fair value of the non-cash consideration.

The SME measures the non-cash consideration based on the stand-alone selling price of the car that will be transferred to the customer. The stand-alone selling price of the car is CU1,000. The SME recognises revenue of CU1,000 when it transfers the car to the customer.

Sales with a right of return

23A.23 An entity might sell a product and give the customer the right to return the product in exchange for any combination of:

(a) a full or partial refund of any consideration paid;

(b) a credit that can be applied against amounts owed, or that will be owed, to the entity; or

(c) another product.

Educational notes

The requirements for sales with a right of return relate to Step 3 of the revenue recognition model. An entity applies these requirements if a customer must return a product to receive a refund, credit or another product from the entity. If a customer is not required to return a product but is still entitled to a refund, an entity applies the requirements for refund liabilities in paragraphs 23.33–23.34.

Paragraph 23A.23 lists what items a customer might receive in exchange for returning the product to an entity. An entity might offer customers one or some of these items.

Interaction with paragraph 23A.25

A sale with a right of return includes contracts where an entity gives the customer the right to return a product for another product. However, when determining the refund liability in accordance with paragraph 23A.25, an entity excludes:

- products expected to be returned and exchanged for another of the same type, quality, condition and price (for example, one colour or size of product for another); and
- defective products expected to be returned and exchanged for functioning products.

Therefore, not all exchanges of a product for another would give rise to a refund liability.

Example—Sales with right of return and refund liabilities

Ex 141 An SME sells goods online.

Customers can return goods within 90 days of receipt and receive a full refund.

The SME charges an additional fee to deliver goods within three days of being ordered. Customers are entitled to a refund of the additional delivery fee if goods are not delivered within three days.

Customers have a right to a refund of any consideration paid if they return goods to the SME. The SME applies paragraphs 23A.24–23A.26 to account for the refund liability relating to the sales of goods.

Customers have a right to a refund of any additional delivery fees paid if the goods are not delivered within three days of being ordered. Because customers are not required to return any goods or services to be entitled to this refund, the SME applies paragraphs 23.33–23.35 to account for the refund liability relating to the additional delivery fee.

23A.24 To account for products sold with a right of return, an entity shall recognise:

(a) revenue for consideration received or receivable for transferred products the entity expects not to be returned;

(b) a refund liability for consideration received or receivable for transferred products the entity expects to be returned; and

(c) a returns asset for transferred products the entity expects to be returned (and corresponding adjustment to cost of sales) classified as **inventory** and measured in accordance with paragraphs 23A.26–23A.27.

23A.25 Products an entity expects to be returned shall exclude:

(a) products expected to be returned and exchanged for another of the same type, quality, condition and price (for example, one colour or size of product for another); and

(b) defective products expected to be returned and exchanged for functioning products.

23A.26 An entity shall initially measure the returns asset at the former **carrying amount** of the products the entity expects to be returned minus:

(a) any expected costs to recover those products; and

(b) any allowances for possible decreases in the value of those products (for example, because of damage, obsolescence or declining selling prices).

Educational notes

An entity recognises the items listed in paragraph 23A.24 when accounting for products sold with a right of return. The entity would be expected to recognise the refund liability and returns asset as an adjustment at the end of the reporting period.

The starting point for measuring the items listed in paragraph 23A.24 is the products an entity expects to be returned. A product is either expected to be returned or expected not to be returned. Therefore, if an entity expects 30% of the products it has transferred to be returned, the remaining 70% of the products are expected not to be returned.

Portfolio approach

The requirements in paragraphs 23A.24–23A.26 assume an entity accounts for products sold with a right of return as a portfolio instead of on an individual basis. In accordance with paragraph 23.5, an entity groups contracts in a portfolio of similar contracts and applies Section 23 to the portfolio if the entity reasonably expects that the result of doing so would not differ materially from the result of applying the section to each individual contract.

How an entity groups contracts into portfolios for accounting for products with a right of return will depend on how its expectations about returns differ. An entity might group contracts and make separate estimates for the number of products expected to be returned for each product line or distribution channel. For example, the grouping of contracts might reflect that customers are:

- less likely to return low-value products than high-value products; or
- less likely to return products purchased in-store than products purchased online.

Products excluded from those the entity expects to be returned

When estimating the products it expects to be returned for the purpose of measuring a contract liability and returns asset, an entity excludes products it expects to be exchanged as described in paragraph 23A.25:

- products exchanged for another product of the same type, quality, condition and price; or
- defective products exchanged for functioning products.

The exchanges described in paragraph 23A.25 refer to the conclusion of the contract. Consequently, when estimating the products it expects to be returned, an entity excludes products it expects to be exchanged. However, the entity includes products it expects to be exchanged but returned later.

Defective products

If an entity exchanges defective products for functioning products, the entity's obligation to repair or replace defective products for customers is accounted for in accordance with the requirements for warranties in paragraphs 23A.5–23A.7.

Regardless of how the entity accounts for such an obligation, the entity excludes defective products expected to be returned and exchanged for functioning products for the purpose of measuring a contract liability and returns asset. However, defective products expected to be returned and exchanged for a refund of consideration or credit are not excluded for the purpose of measuring a contract liability and returns asset. Therefore, if an entity offers customers the choice of a refund or a repair/replacement of defective products, the entity would be expected to estimate the number of customers that would choose each option. The entity would recognise:

- revenue for defective products expected to be returned and exchanged for functioning products; and
- a contract liability and returns asset for defective products expected to be returned and refunded.

Returns asset

When recognising a returns asset, the corresponding adjustment would be to cost of sales if an entity presents an analysis of its expenses by function. However, if the entity presents an analysis of its expenses by nature, the corresponding adjustment would be to a line item made up of expenses classified by nature (for example, 'Changes in inventories of finished goods, work in progress and returns asset').

The starting point for measuring a returns asset is the product's former carrying amount, that is, the amount at which the product was recognised in the statement of financial position before it was sold. The carrying amount is then adjusted for the factors in paragraph 23A.26:

- *any expected costs to recover those products* (paragraph 23A.26(a))—for example, the cost of transporting the products to the entity, if paid by the entity, or the costs of inspecting, repackaging and restocking the products.
- *any allowances for possible decreases in the value of those products* (paragraph 23A.26(b))—the entity might be unable to resell the returned products or might resell them at a reduced price. The allowance would represent the decrease in value to the entity of the products. Adjusting for this allowance is consistent with the requirement to measure inventory at the estimated selling price less costs to complete and sell, if that amount is less than the cost of the inventory (see paragraph 13.4).

Paragraph 23A.26(b) lists 'possible decreases in the value of products … because of damage' as an example of an adjustment to the carrying amount of a product when measuring the returns asset. Therefore, an entity would be expected to adjust the carrying amount of a product for possible damage to the product when it is returned. However, defective products expected to be returned and exchanged for functioning products are not included in the measurement of the returns asset (see paragraph 23A.25(b)).

An entity may use an alternative term to describe a returns asset in its financial statements in accordance with paragraph 4.9(b).

Example—Portfolio approach

Ex 142 An SME sells sports equipment and clothing. The SME sells equal numbers of equipment and clothing. However, revenue from equipment sales is greater than revenue from clothing sales because the selling price of sports equipment is higher than the selling price of clothing.

Customers can return products within 30 days of receipt and receive a full refund.

Historically, the SME has an average return rate of 20% of products sold. However, the rate of return for clothing is higher than the rate of return for sports equipment.

To measure the refund liability, the SME makes a separate estimate for equipment sales and clothing sales.

The SME does not measure the refund liability using the average return rate for all products. This is because it reasonably expects that the result of doing so would be materially different from the result of measuring the refund liability based on separate estimates for sales of sports equipment and sales of clothing.

Examples—Accounting for products with right of return

Ex 143 An SME runs a chain of children's footwear shops. Customers can return unworn products within 60 days of purchase and receive a credit that they can use against future purchases from the SME.

The SME transfers CU80,000 of products in the final 60 days of the reporting period. CU10,000 of the products have been returned by customers at the reporting date.

The SME expects a further CU5,000 of products sold in the final 60 days of the reporting period to be returned by customers in the next reporting period.

Of the products the SME expects to be returned in the next reporting period, the SME expects CU3,000 of products will be returned and swapped for a different size. The SME does not expect any of the swapped products to be returned later. The SME excludes these products when measuring the refund liability (and returns asset). The SME includes these products when recognising revenue.

The SME does not expect any decrease in the value of the products that are returned. The carrying amount of the products the SME expects to be returned in the next reporting period (excluding products that will be returned and swapped for a different size) is CU1,300.

To account for the CU80,000 of products transferred in the final 60 days of the reporting period, the SME recognises:

- revenue of CU68,000 (CU80,000 – CU10,000 – (CU5,000 – CU3,000));
- a refund liability of CU2,000 (CU5,000 – CU3,000); and
- a returns asset of CU1,300.

Ex 144 An SME sells Product A for CU80. Customers can return the product within six months of purchase and receive a full refund. Return shipping costs of CU5 per product are paid by the SME. The cost of Product A is CU40.

The SME transfers 6,400 products in the final six months of the reporting period. Of these products, 320 have been returned by customers at the reporting date.

Historically, 30% of products are returned. Therefore, the SME expects a further 1,600 products ((6,400 products × 30%) – 320 products) to be returned in the next reporting period and expects to refund the full price of these products.

Of the products that are expected to be returned in the next reporting period, 10% are expected to be defective (160 products = 1,600 products × 10%). Customers sold defective products are given a full refund. Therefore, the SME includes these products when measuring the refund liability (and returns asset).

Historically, 50% of the returned products are shipped back to the SME, with the remainder being returned in person. Therefore, the SME deducts expected costs of CU4,000 (1,600 products × CU5 × 50%) for recovering the products expected to be returned when measuring the returns asset.

Defective products are unable to be resold and are disassembled for spare parts. This decreases the value of these products by 80% of their selling price (CU16 = (100% – 80%) × CU80). Therefore, the SME also deducts CU3,840 (160 products × (CU40 – CU16)) for the decrease in value of the products expected to be returned when measuring the returns asset.

To account for the 6,400 products transferred in the final six months of the reporting period, the SME recognises:

- revenue of CU358,400 ((6,400 products × 70%) × CU80);
- a refund liability of CU128,000 (1,600 products × CU80); and
- a returns asset of CU56,160 ((1,600 products × CU40) – CU4000 – CU3,840).

23A.27 At the end of each reporting period, an entity shall adjust the refund liability and returns asset for changes in its expectations about products to be returned. The entity shall recognise adjustments to:

(a) the refund liability in revenue; and

(b) the returns asset as an expense.

Educational notes

An entity would be expected to adjust the refund liability and returns asset by comparing their balances at the current and prior reporting dates. Table 4 summarises the adjustments an entity would recognise depending on the movement in the balances.

Table 4—Adjustments to refund liability and returns asset

Refund liability	
Movement between reporting dates	***Adjustment***
Balance increased ↑	Dr Revenue Cr Refund liability
Balance decreased ↓	Dr Refund liability Cr Revenue

Returns asset	
Movement between reporting dates	***Adjustment***
Balance increased ↑	Dr Returns asset Cr Cost of sales
Balance decreased ↓	Dr Cost of sales Cr Returns asset

The adjustments result in an entity recognising changes in expectations about products to be returned in the period of the change (that is, prospectively). This is consistent with the requirements for accounting for changes in accounting estimates in Section 10 *Accounting Policies, Estimates and Errors*.

Disclosing changes in accounting estimates

Section 10 requires an entity to disclose information about changes in accounting estimates (see paragraph 10.18).

No disclosure is typically necessary for products with returns periods of less than 12 months because estimates about the refund liability and return asset associated with such products are not updated at a future reporting date and the accounting estimate does not change between the reporting dates. The estimates are not updated at a future reporting date because they relate to products that will either have been returned, or the right of return will have expired, by that date.

Example—Adjustments to refund liability and returns asset

Ex 145 The facts are the same as in Example 144.

The SME had an opening refund liability of CU86,000 and an opening returns asset of CU41,280 for sales of Product A.

At the end of the reporting period, the SME recognises a refund liability of CU128,000 and a returns asset of CU56,160 for Product A (see Example 144). The following journal entries illustrate how the SME adjusts the refund liability and returns asset:

(a) The SME recognises the increase of CU42,000 (CU128,000 – CU86,000) in the refund liability balance as a reduction of revenue:

Dr Revenue	CU42,000	
Cr Refund liability		CU42,000

(b) The SME recognises the increase of CU14,880 (CU56,160 – CU41,280) in the returns asset balance as an expense:

Dr Returns asset	CU14,880	
Cr Cost of sales		CU14,880

Licensing

23A.28 A licence gives a customer rights to an entity's intellectual property (such as software, technology, trademarks, patents, franchises, music and motion picture films).

23A.29 If a contract with a customer includes a licence (or licences) and other goods or services, an entity shall apply Step 2 to identify each of the promises in the contract. If the licence is not distinct from the other goods or services in the contract, an entity shall apply Step 5 to determine whether the promise to grant the licence is fulfilled over time or at a point in time. If the licence is distinct from the other goods or services in the contract, an entity shall apply paragraphs 23A.30–23A.36 to determine whether the promise to grant the licence is fulfilled over time or at a point in time.

Educational notes

The requirements for licensing relate to Step 5 of the revenue recognition model. The requirements determine whether an entity fulfils a promise to grant a licence over time or at a point in time.

Intellectual property of an entity

An entity applies the requirements when licensing its own intellectual property, not the intellectual property of another entity. For example, an IT retailer selling software licences that give customers the right to the intellectual property of a technology company would not apply the requirements.

Distinct licence

An entity applies the requirements when it grants a licence that is distinct from the other goods or services in the contract. However, a licence is often not distinct because:

- the customer can only benefit from the licence with another good or service that is promised in the contract—see paragraph 23.18(a); or
- the obligation to grant the licence is not separate from other obligations in the contract because:
  - the licence is integrated with other goods or services that transform them into a combined output that the customer is buying—see paragraph 23.21(a) (for example, medical testing equipment that includes a licence for the software that detects medical conditions); or
  - the licence is highly dependent on or highly related to another good or service in the contract—see paragraph 23.21(c) (for example, a licence to create an entertainment series that relies on the entity producing the series for the customer).

If the licence is not distinct, it is included in a bundle with other goods or services. The entity applies the requirements in Step 5 to determine whether the distinct bundle of goods or services is transferred over time or at a point in time. However, if the licence is the primary good or service in the contract, an entity might find the requirements in paragraphs 23A.30–23A.36 useful when making this determination.

Example—Licence is distinct

Ex 146 An SME enters into a contract to license a recipe to a large manufacturer (the customer).

The SME also agrees to transfer 500,000 units of an ingredient used in the recipe to the customer. The ingredient can be obtained from other suppliers.

The SME concludes that the criterion in paragraph 23.18(a) is met for the licence and ingredient because the customer can benefit from the licence and ingredient either on their own or together with other resources readily available to the customer.

The SME concludes that the criterion in paragraph 23.18(b) is met for the licence and ingredient because:

- although the ingredient is required in the recipe, the entity does not combine the ingredient and recipe into a combined function. The SME also does not provide any service that integrates the ingredient and recipe in transferring both inputs.
- neither the licence nor the ingredient modify or customise the other.
- the SME could grant the licence without transferring the ingredient (or could transfer the ingredient without granting the licence). This fact suggests the licence and ingredient are not highly dependent on, highly related to or highly affected by each other.

Consequently, the SME accounts for the licence as a separate promise, and applies paragraphs 23A.30–23A.36 to determine whether the promise is fulfilled over time or at a point in time.

Example—Licence is not distinct

Ex 147 An SME enters into a contract to license the right to manufacture a drug for five years to a customer. The contract restricts the customer from reselling the licence.

The SME also agrees to manufacture the drug for the customer. No other entity can manufacture the drug because of the highly specialised nature of the manufacturing process.

The SME concludes that the criterion in paragraph 23.18(a) is not met for the licence and manufacturing service because the customer cannot benefit from the licence by reselling it or without the manufacturing service.

Consequently, the SME accounts for the licence and manufacturing service as a single promise, and applies Step 5 to determine whether the promise is fulfilled over time or at a point in time.

23A.30 To determine whether the promise to grant a licence is fulfilled over time or at a point in time, an entity shall consider whether the licence gives the customer either:

(a) a right to access the entity's intellectual property as it exists throughout the licence period, in which case the entity fulfils the promise (and recognises revenue) over time; or

(b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted, in which case the entity fulfils the promise (and recognises revenue) at a point in time.

Educational notes

When a promise to grant a licence is fulfilled is based on the type of right that the licence gives a customer. The type of right is based on the activities undertaken by the entity during the contract.

A licence will either give a customer:

- a right to access an entity's intellectual property (and the promise is therefore fulfilled over time); or
- a right to use an entity's intellectual property (and the promise is therefore fulfilled at a point in time).

Section 23 requires an entity to first consider whether a licence gives a customer a right to access the entity's intellectual property (and the promise is therefore fulfilled over time). If the promise is not fulfilled over time, it is fulfilled at a point in time (see paragraph 23A.35).

Consistent with Step 5, an entity determines at the start of the contract when it fulfils a promise to grant a licence and is not expected to revisit this assessment (see paragraph 23.52).

23A.31 A licence gives a customer a right to access an entity's intellectual property if the entity expects to undertake activities:

(a) that *will* substantively affect the customer's benefit from the intellectual property by changing the intellectual property's substance (see paragraph 23A.33); or

(b) that *could* substantively affect the customer's benefit from the intellectual property by directly exposing the customer to any positive or negative effects of those activities (see paragraph 23A.34).

23A.32 An entity's expected activities might be included in the terms of a contract or might be activities that a customer reasonably expects the entity will undertake. For the purpose of applying the criteria in paragraph 23A.31, the entity shall exclude activities that result in the transfer of a good or service to the customer.

23A.33 Activities undertaken by the entity that change the intellectual property's substance include activities that change the intellectual property's design, content or ability to do a function or task (for example, development activities that change the content to which the customer has rights).

23A.34 Activities undertaken by the entity that directly expose the customer to positive or negative effects include activities that support or maintain the value of intellectual property (for example, ongoing activities that maintain the value of the brand to which the customer has rights).

23A.35 If either criterion in paragraph 23A.31 is met, the promise to grant a licence is fulfilled over time. Otherwise, the promise is fulfilled at a point in time.

Educational notes

Paragraph 23A.31 describes the two activities that result in a promise to grant a licence being fulfilled over time.

An entity's assessment of the activities it will undertake is made at the start of the contract and therefore based on the activities it *expects* to undertake. The activities might be stated in the contract or implied by the entity's usual business practices. As the requirements for licensing apply only to promises where the licence is distinct, an entity excludes activities that result in the transfer of a good or service to the customer and give rise to a promise. For example, if an entity accounts for a licence and promotional services as separate promises, the entity does not consider the promotional services when assessing the type of activities it expects to undertake.

If an entity does not expect to undertake any activities after making the intellectual property available to the customer, neither criterion in paragraph 23A.31 is met and the promise is fulfilled at a point in time (see Example 150). An example is where an entity expects to grant a licence and to have no further obligations related to the intellectual property.

Activities that change the intellectual property's substance (paragraphs 23A.31(a) and 23A.33)

Activities that meet the criterion in paragraph 23A.31(a) go beyond maintaining the substance of the intellectual property and change it.

Paragraph 23A.33 describes three ways an activity could change the intellectual property's substance:

- by changing the intellectual property's design (for example, a licence to use images of comic strip characters, where the images of the characters evolve over time);
- by changing the intellectual property's content (for example, a licence to use a set of typefaces, where the selection of typefaces is regularly updated); and
- by changing the intellectual property's ability to do a function or task (for example, a licence to use software, where the software is regularly updated to improve its functionality).

Activities that directly expose the customer to positive or negative effects (paragraphs 23A.31(b) and 23A.34)

Activities that meet the criterion in paragraph 23A.31(b) have the potential to change the value of the intellectual property, which could substantively affect the benefit a customer obtains from it. These activities will usually be aimed at supporting or maintaining the value of intellectual property.

Positive and negative effects

An entity will typically undertake activities aimed at maintaining or increasing the customer's benefit from the intellectual property. The reference in the criterion to 'negative effects' acknowledges that there might be uncertainty about whether the customer's benefit will be maintained or increased because there is a possibility that the entity's activities will decrease the customer's benefit. For example:

- a licence to use a sports team logo, where the entity (the sports team) expects to continue to play sport. This activity might increase the customer's benefit (if the team wins) or decrease the customer's benefit (if the team loses).
- a licence to use a brand, where the entity expects to undertake marketing campaigns. This activity might increase the customer's benefit (if the campaign is successful) or decrease the customer's benefit (if the campaign is unsuccessful).

Examples—Customer has right to access SME's intellectual property

Ex 148 An SME operates a chain of language schools. It licenses its learning materials to educational institutions (its customers).

The contracts the SME has with its customers specify that it will add learning materials covering new topics each month.

Adding new content to the learning materials does not directly transfer a good or service to the customer because it is part of the SME's promise to grant the licence.

The SME concludes that the criterion in paragraph 23A.31(a) is met because it expects to change the substance of the learning materials by adding new content. Such updates will substantively affect the customer's benefit from the educational materials.

Therefore, the nature of the SME's promise in granting the licence is to provide a right to access the learning materials as they exist throughout the licence period. Consequently, the SME accounts for the licence as a promise fulfilled over time.

Ex 149 An SME operates a chain of health clubs. The SME enters into a contract with a sportswear and fitness equipment retailer (the customer). The contract gives the customer the right to use the SME's logo on clothing for 12 months.

As part of the SME's customary business practice, it will undertake marketing and promotional activities to increase the health club's membership and maintain its brand. Therefore, the SME concludes that the customer would reasonably expect the SME to undertake such activities. The activities do not directly transfer a good or service to the customer because they are part of the SME's promise to grant the licence.

The SME concludes that the criterion in paragraph 23A.31(b) is met because the marketing and promotional activities could substantively affect the customer's benefit from using the SME's logo by directly exposing the customer to any positive or negative effects of those activities.

Therefore, the nature of the SME's promise in granting the licence is to provide a right to access the SME's brand (by using the logo) as it exists throughout the licence period. Consequently, the SME accounts for the licence as a promise fulfilled over time.

Examples—Customer has right to use SME's intellectual property

Ex 150 An SME enters into a contract to license a recipe to a large manufacturer (the customer).

The SME has produced goods using the recipe for the past 15 years without the recipe being modified.

The SME concludes that neither criterion in paragraph 23A.31 is met because it does not expect to undertake any activities to support the recipe.

Therefore, the nature of the SME's promise in granting the licence is to provide a right to use the recipe as it exists at the point in time the licence is granted. Consequently, the SME accounts for the licence as a promise fulfilled at a point in time.

Ex 151 An SME licences music editing software, which customers can use for 12 months and operate through an online application.

During the contract, the SME maintains the web server that hosts the application. The maintenance is minimal and carried out occasionally. The SME does not update the software, other than modifying it to resolve minor issues.

The SME expects to modify the software to resolve minor issues. Because any changes arising from modifying the software are not expected to substantively affect the customer's benefit from the software, the SME concludes that the criterion in paragraph 23A.31(a) is not met.

Although the web server is necessary for a customer to operate the software, the value of the software is its ability to edit music. Because the activities required to maintain the server do not support or maintain the software's ability to edit music, and do not have the potential to change its value, the SME concludes the criterion in paragraph 23A.31(b) is not met.

Therefore, the nature of the SME's promise in granting the licence is to provide a right to use the software as it exists at the point in time the licence is granted. Consequently, the SME accounts for the licence as a promise fulfilled at a point in time.

23A.36 If a promise to grant a licence is fulfilled over time, an entity shall apply paragraphs 23.62–23.67 to choose an appropriate method to measure its progress towards fulfilment of that promise. If a promise to grant a licence is fulfilled at a point in time, an entity shall apply paragraphs 23.57–23.61 to identify the point in time the licence transfers to the customer, which cannot be before the customer is able to use and benefit from the licence.

Educational notes

Paragraph 23A.36 directs an entity to the appropriate section of Step 5 depending on whether a promise to grant a licence is fulfilled over time or at a point in time.

If a promise to grant a licence is fulfilled at a point in time, paragraph 23A.36 prevents the specific point in time when the licence transfers to the customer being before the customer can use and benefit from the licence. The point in time that a customer can use and benefit from a licence might not coincide with the start of the licence period (see Example 152).

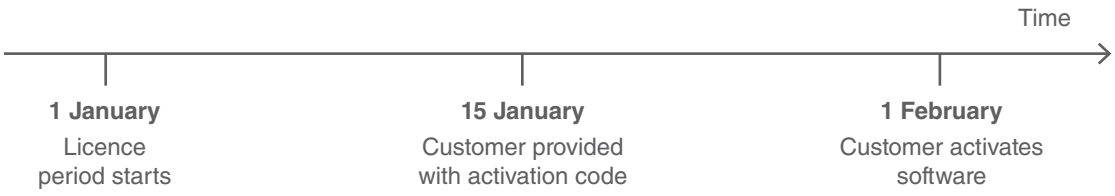
Example—Identifying the point in time licence transfers to customer

Ex 152 An SME enters into a contract to license software to a customer for CU800.

The SME provides the customer with an activation code that the customer needs before it can use the software. For billing purposes, the licence period starts on 1 January 20X1. However, the SME does not provide the customer with the activation code until 15 January 20X1. The customer activates the software on 1 February 20X1.

The events in the contract are summarised in Figure 28.

Figure 28—Contract timeline



The SME accounts for the contract as a single promise fulfilled at a point in time.

The customer is able to use and benefit from the licence only on 15 January 20X1, when it receives the activation code. On this date, the SME concludes that the customer has obtained control of the licence and recognises revenue of CU800.

Although the customer waits until 1 February 20X1 to activate the software, the customer is able to use and benefit from the licence before this date. Therefore, when the customer activates the software does not affect the point in time the licence transfers to the customer.

Sales-based or usage-based royalties

23A.37 An entity might grant a licence of intellectual property in exchange for a royalty based on sales or use. If the licence is the sole or main item to which the royalty relates, the entity shall recognise revenue for such a royalty when (or as) the later of two events happens:

(a) the promise to which some or all of the royalty has been allocated has been fulfilled (or partially fulfilled); or

(b) the subsequent sale or use takes place.

Educational notes

The requirements for sales-based or usage-based royalties relate to Steps 3 and 5 of the revenue recognition model.

The requirements prevent an entity recognising revenue for such royalties until the uncertainty associated with the royalty is resolved (that is, once the sale or use takes place). This is different from the requirements for variable consideration in Step 3, which might require an entity to recognise variable consideration as revenue before the uncertainty associated with the consideration is resolved.

Scope of requirements

The requirements for sales-based or usage-based royalties apply only if the royalty relates to a licence of intellectual property. Sales-based or usage-based royalties that do not relate to a licence of intellectual property (for example, a royalty paid by customers for use of a natural resource) are accounted for in accordance with the requirements for variable consideration in Step 3.

Interaction between the events specified in paragraph 23A.27

Paragraph 23A.37(b) prevents an entity recognising revenue for sales-based or usage-based royalties before the sale or use takes place. Paragraph 23A.37(a) prevents an entity recognising revenue for such a royalty before the promise to which the royalty has been allocated has been fulfilled (or begun to be fulfilled).

Contracts where an entity receives a sales-based or usage-based royalty will typically include a single promise: the promise to grant the licence. The entity will allocate the royalty to this promise. A licence must be granted to a customer before it begins using the licence or selling the goods or services related to the licence. Therefore, the promise will be fulfilled (or partially fulfilled) before the subsequent sale or use takes place. Consequently, for these contracts, the later event in paragraph 23A.37 is '(b)': the subsequent sale or use.

However, contracts where an entity receives a sales-based or usage-based royalty could include a promise to grant the licence and another promise. The entity might allocate the royalty to both promises in accordance with the requirements for allocating variable consideration in Step 4 (see Example 154). If the entity begins to fulfil the promise to grant the licence before it begins to fulfil the other promise, the entity is required to wait until it begins to fulfil the other promise before it recognises the royalty allocated to that promise as revenue. In this example, the later event in paragraph 23A.37 is '(a)': the promise to which some or all of the royalty has been allocated being fulfilled (or partially fulfilled).

If a sales-based or usage-based royalty is allocated to a promise that is fulfilled over time, the Standard requires the entity to wait until the promise is 'partially fulfilled' before the royalty can be recognised as revenue. The entity is not required:

- to wait until the promise is completely fulfilled; or
- to recognise the royalty in proportion to the entity's progress towards fulfilment of that promise.

Information about sales or usage

Entities often receive information about customers' sales or usage after they have occurred. Consequently, an entity might need to estimate a customer's sale or usage when recognising revenue for sales-based or usage-based royalties (for example, sales for the final three months of the reporting period).

The receipt of information after the end of the reporting period about customers' sales or usage before the end of the reporting period is an example of an adjusting event (see Section 32 *Events after the End of the Reporting Period*). An entity would adjust the amount of revenue recognised in its financial statements to reflect this information if it was received before the entity's financial statements were authorised for issue.

Example—Usage-based royalty

Ex 153 An SME licenses the right to manufacture a patented product to a customer for 12 months. The customer pays the SME CU4,000 at the beginning of the contract and CU2 each time it manufactures the product.

The SME accounts for the licence as a single promise fulfilled at a point in time.

The SME recognises CU4,000 of revenue when it transfers the licence at the beginning of the contract.

The SME recognises revenue from the usage-based royalty when the products are manufactured. At the end of the reporting period, the customer has manufactured 3,000 products and the SME recognises revenue for the royalty of CU6,000 (3,000 × CU2).

Example—Sales-based royalty allocated to two promises

Ex 154 The facts are the same as in Example 148.

The SME enters into a contract with a customer to license its learning materials for 12 months. Included in the contract is a training programme for the customer's tutors. In exchange for the licence and training, the customer pays the SME 15% of the sales price of any courses sold that use the SME's learning materials.

The licence and training programme are distinct. The SME accounts for the licence and training services as separate promises. Both promises are fulfilled over time (see Example 148).

The SME determines that the stand-alone selling prices are as follows:

Promise	Stand-alone selling price
	CU
Licence	4,000
Training	3,000
Total	7,000

The sales-based royalty is the only consideration the SME is entitled to under the contract. Although the royalty payments relate specifically to the customer's sales that use the licence, allocating the payments entirely to the licence would not represent the amount of consideration the SME expects to be entitled to in exchange for the licence and training. Therefore, the SME allocates the sales-based royalty to both promises on a relative stand-alone selling price basis.

The licence is transferred to the customer at the start of the contract and the training services are transferred nine months later.

In the first nine months of the contract, the royalty due from the customer's sales is CU5,110. The variable consideration is allocated as follows:

Promise	Allocated royalty	Calculation
	CU	
Licence	2,920	CU5,110 × (CU4,000 ÷ CU7,000)
Training	2,190	CU5,110 × (CU3,000 ÷ CU7,000)
Total	5,110	

The SME recognises:

- CU2,920 allocated to the licence as revenue because it relates to a promise that has been partially fulfilled; and
- CU2,190 allocated to the training services as a contract liability because it relates to a promise that has yet to be fulfilled.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the Standard to transactions or other events often requires the exercise of judgement. Information about significant judgements made by an entity's management and key sources of estimation uncertainty is useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity discloses the judgements management has made when applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7, an entity discloses information that explains key assumptions about the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Also in accordance with paragraph 23.87, an entity discloses information about judgements that have had a significant effect on the amounts recognised in the financial statements when determining and allocating the transaction price. Section 23 requires disclosure of these particular judgements because they involve estimates. Judgements that involve estimates are not within the scope of paragraph 8.6 and, depending on their nature, might not be within the scope of paragraph 8.7.

Recognition

Sometimes significant judgement is required to identify the contract to which an entity applies the revenue recognition model (Step 1) and identify the promises in that contract (Step 2). For example, significant judgement might be needed:

- to identify the promises in the contract if a contract contains more than one good or service;
- to determine whether an entity's promise is to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for the other party to provide those goods or services (that is, the entity is an agent) if another party is involved in providing goods or services to a customer;
- to determine whether contracts are required to be accounted for as a single contract if they are entered into at or near the same time with the same customer;
- to identify whether the revenue recognition model can be applied to a portfolio of contracts or promises instead of on an individual basis if an entity has several contracts or promises that are similar; and
- to determine whether an option granted to a customer to acquire additional goods or services for free or at a discount can be accounted for as a separate promise without undue cost or effort.

In some cases, significant judgement is required to determine when the promises identified in Step 2 are fulfilled and revenue is recognised (Step 5). For example:

- significant judgement might be required to determine whether control of the distinct good or service in a promise is transferred to a customer over time or at a point in time. This determines when the promise is fulfilled and revenue is recognised.

- if a promise is fulfilled over time, significant judgement might be required to select a method to measure progress that depicts an entity's performance in transferring control of the goods or services promised to the customer. Significant judgement might also be required to apply the selected method. If an output method is selected, significant judgement might be required to estimate the value to the customer of the goods or services transferred to the customer. If an input method is selected, significant judgement might be required to estimate the total expected inputs to fulfil the promise.
- if a promise is fulfilled at a point in time, significant judgement might be required to identify the specific point in time a customer obtains control of the goods or services promised to the customer.

Measurement

An entity measures revenue using the transaction price, which is the amount of consideration the entity expects to be entitled to in exchange for transferring goods or services in the contract (Step 3). For many contracts, an entity does not need to apply judgement to determine the transaction price: the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents. However, for some contracts, significant judgement is required. For example, significant judgement might be needed:

- to measure the amount of consideration to include in the transaction price if the consideration the entity expects to be entitled to is variable.
- to estimate the number of products the entity expects not to be returned and recognised as revenue if products are sold with a right of return.
- to determine whether the arrangement constitutes a financing transaction and whether the promised consideration is required to be discounted if the payment is deferred. Where the arrangement does constitute a financing transaction, significant judgement might be needed to determine the discount rate.
- to measure the fair value of the consideration if it is in a form other than cash.

In Step 4, the transaction price is allocated to each promise identified in Step 2. Similar to Step 3, in many cases, an entity does not need to apply judgement to allocate the transaction price to each promise: the transaction price is allocated based on the stand-alone selling prices of the goods or services underlying each promise and those prices are directly observable. However, in some cases significant judgement is required. For example:

- if the stand-alone selling price of the goods or services underlying each promise is not directly observable, significant judgement might be required to estimate that price; and
- if a customer receives a discount or the transaction price includes an amount of variable consideration, significant judgement might be required to determine whether allocating the discount or variable consideration on a relative stand-alone selling price basis represents the amount of consideration to which the entity expects to be entitled.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs* Accounting Standard is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted.

In the third edition of the Standard, the IASB revised Section 23 to be based on IFRS 15 *Revenue from Contracts with Customers*. Appendix A *Effective date and transition* of the Standard provides requirements for entities on transition to the third edition of the Standard. The Appendix includes requirements for entities initially applying the revised Section 23 *Revenue from Contracts with Customers* that previously applied Section 23 *Revenue*.

Revenue from contracts with customers

A27 An entity shall apply the revised Section 23 *Revenue from Contracts with Customers* consistently to all **contracts** with **customers** either:

(a) retrospectively in accordance with Section 10, subject to paragraphs A28–A31; or

(b) prospectively from the date of initial application in accordance with paragraphs A32–A36.

Educational notes

Appendix A provides an entity with an accounting policy choice between applying the revised Section 23 retrospectively or applying the Section prospectively.

Difference between retrospective and prospective application

On transition to the third edition of the Standard, an SME's accounting policy for revenue is changed from being based on the previous Section 23 to being based on the revised Section 23. The periods in which the entity uses the new accounting policy differ depending on whether the entity applies the revised Section 23 retrospectively or prospectively.

If an entity retrospectively applies the revised Section 23, the entity's accounting policy for revenue for the current period and prior periods presented is based on the revised Section 23. Therefore, the entity applies one accounting policy for revenue and restates comparative information.

If an entity prospectively applies the revised Section 23, only the entity's accounting policy for revenue for contracts that begin in the current period is based on the revised Section 23. The entity's accounting policy for revenue for prior periods presented, and for contracts that begin in those periods, is based on the previous Section 23. Therefore, the entity applies two accounting policies for revenue and does not restate comparative information.

Consistent application

An entity's accounting policy choice between applying the revised Section 23 prospectively or retrospectively applies to all contracts with customers, and not on a contract-by-contract basis. Consequently, an entity is prevented from applying the revised Section 23 retrospectively to some contracts and prospectively to others.

Choosing between retrospective and prospective application

Retrospective application ensures that all contracts with customers are recognised and measured consistently between the current period and the prior periods presented. Consequently, retrospective application provides users of financial statements with more useful trend information across the current and comparative periods than prospective application.

Applying the revised Section 23 to some contracts might result in significant changes to the amount and timing of revenue recognised. It would be more costly and complex for an entity to retrospectively apply the revised Section 23 to these contracts compared with contracts where applying the revised Section 23 results in the amount or timing of revenue recognised remaining unchanged, or results in only minimal changes. If the amount or timing of revenue recognised by an entity remains unchanged when applying the revised Section 23, or results in only minimal changes, then the cost and complexity of applying the revised Section 23 retrospectively or prospectively might be similar.

Retrospective application

A28 If an entity retrospectively applies the revised Section 23, it is permitted to use one or more of three exemptions:

(a) for completed contracts, an entity is not required to restate contracts that:

(i) begin and end within the same reporting period; or

(ii) were completed at the beginning of the earliest period presented.

(b) for completed contracts that have variable consideration, an entity is permitted to use the transaction price at the date the contracts were completed instead of estimating amounts of variable consideration for the comparative reporting periods.

(c) for contracts that were modified before the beginning of the earliest period presented, an entity is not required to retrospectively restate those contract modifications in accordance with paragraphs 23A.3–23A.4. Instead, the entity is permitted to reflect the aggregate effect of all modifications that occurred before the beginning of the earliest period presented when it:

(i) identifies the fulfilled and unfulfilled **promises**;

(ii) determines the transaction price; and

(iii) allocates the transaction price to the fulfilled and unfulfilled promises.

A29 In paragraph A28(a)–(b), a completed contract is a contract for which the entity has transferred all goods or services identified in accordance with the requirements for accounting for **revenue** from contracts with customers that were replaced by the revised Section 23.

A30 If an entity uses any of the exemptions in paragraph A28, the entity shall disclose that fact and apply that exemption consistently to all periods presented.

Educational notes

Appendix A provides three optional exemptions for an entity retrospectively applying the revised Section 23. If an entity applies an exemption, that exemption is applied to all applicable contracts, and not on a contract-by-contract basis.

The exemptions use the term ‘completed contract’, which is explained in paragraph A29. The explanation describes an entity transferring the goods or services identified in a contract. The concept of an entity transferring goods or services is not included in the previous Section 23. However, in many contracts, an entity will have transferred goods when they are delivered and transferred services when they are performed.

Not to restate completed contracts (paragraph A28(a))

The exemption in paragraph A28(a) reduces the number of contracts an entity is required to restate by not requiring an entity to restate the contracts described in paragraph A28(a). Not restating these contracts is unlikely to change the amount or timing of revenue recognised in the prior periods presented because the contracts either do not span a reporting date (see paragraph A28(a)(i)) or relate to a comparative period that is not presented (see paragraph A28(a)(ii)).

Allowing hindsight when estimating variable consideration (paragraph A28(b))

The exemption in paragraph A28(b) allows an entity to use hindsight when accounting for a contract that includes variable consideration. The exemption avoids an entity having to estimate an amount of variable consideration when the amount the entity is entitled to is known because the contract is complete.

The exemption applies only to comparative reporting periods; an entity is still required to estimate amounts of variable consideration for contracts not yet completed at the reporting date.

Allowing hindsight when accounting for the effects of contract modifications (paragraph A28(c))

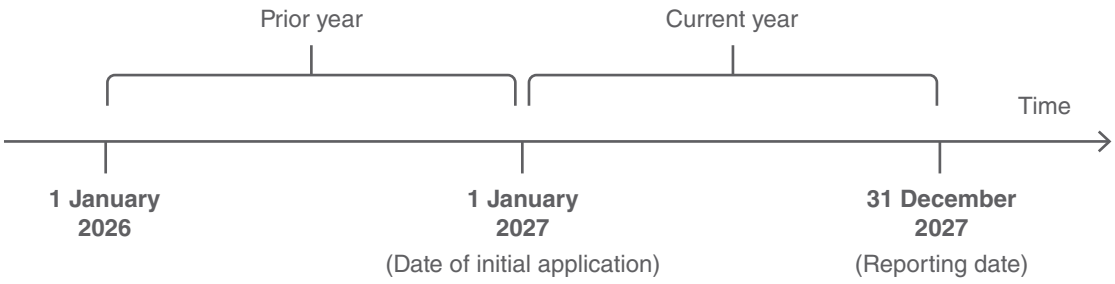
The exemption in paragraph A28(c) allows an entity to use hindsight when accounting for the effects of contract modifications. The exemption allows entities to reflect the aggregate effect of all past contract modifications instead of accounting for the effects of each contract modification separately.

The exemption applies only to modifications that occurred before the beginning of the earliest period presented. Modifications that occurred after the beginning of the earliest period presented are accounted for separately in accordance with paragraphs 23A.3–23A.4.

Example—Exemption in paragraph A28(a)

Ex 155 An SME initially applies the third edition of the *IFRS for SMEs* Accounting Standard for the year ended 31 December 2027. The SME presents one year of comparative information (see Figure 29).

Figure 29—Illustration of the date of initial application and reporting date



The SME sold a product to a customer on 30 September 2025. The SME awards the customer a voucher for 50% off their next purchase. The customer must redeem the voucher within six months.

The SME chooses to retrospectively apply the revised Section 23.

In accordance with the requirements for accounting for revenue in the previous Section 23, the SME concludes that the contract contains one good that is transferred by 31 December 2025. Therefore, the contract is complete at the beginning of the earliest period presented.

The SME uses the exemption in paragraph A28(a) and does not restate the contract. In accordance with paragraph A30, the SME discloses in the notes to its financial statements that contracts completed by 1 January 2026 have not been restated.

If the SME did not use the exemption in paragraph A28(a), it would restate the contract. In accordance with paragraphs 23A.8–23A.13, the SME would account for the option to purchase goods at a discounted price as a separate promise if the voucher grants the customer a material right. The contract would include two promises: the promise to transfer the product and the option to purchase goods at a discounted price.

Example—Exemption in paragraph A28(b)

Ex 156 The facts are the same as in Example 155. However, in this example, the SME entered into a contract with a customer on 1 July 2025 to build a factory. If the building is complete within 12 months, the SME will be entitled to a performance bonus of CU400, in addition to fixed consideration of CU2,000.

The SME chooses to retrospectively apply the revised Section 23.

The SME completes the building in 10 months and is entitled to the performance bonus of CU400.

The SME uses the exemption in paragraph A28(b) and restates the contract using the transaction price at the date the contract was completed (CU2,400 = CU2,000 + CU400). The SME recognises revenue during the year to 31 December 2025, and contract balances at that date, based on that amount. In accordance with paragraph A30, the SME discloses in the notes to its financial statements that the transaction price of completed contracts is based on the transaction price at the date the contracts were completed, instead of an estimate of that amount.

If the SME did not use the exemption in paragraph A28(b), it would estimate the amount of variable consideration at 31 December 2025 based on the SME's expectations at that date. The SME would use the estimate to recognise revenue during the year to 31 December 2025 and contract balances at that date. Depending on the SME's expectations about the contract's completion date at 31 December 2025, the estimate might be less than the CU400 that the SME is entitled to when the contract is complete. For example, the SME might not include any of the CU400 in the transaction price if at 31 December 2025 it did not expect the contract to be complete within 12 months.

Example—Exemption in paragraph A28(c)

Ex 157 The facts are the same as in Example 155. However, in this example, the SME entered into a contract with a customer on 1 January 2025 to supply an alarm system and provide security services for 24 months in exchange for CU4,000. Six months after the contract begins, the contract is modified. The SME agrees to maintain the alarm system and extend the contract by six months for an additional CU800.

The SME chooses to retrospectively apply the revised Section 23.

The SME uses the exemption in paragraph A28(c) and reflects the aggregate effect of the modification when accounting for the contract.

The SME accounts for the alarm system, security services and maintenance services as separate promises and determines their stand-alone selling prices as follows:

Promise	Stand-alone selling price
	CU
Alarm system	1,600
Security services (30 months)	3,000
Maintenance services (24 months)	800
Total	5,400

The transaction price of CU4,800 (CU4,000 + CU800) is allocated as follows:

Promise	Allocated transaction price	Calculation
	CU	
Alarm system	1,422	CU4,800 × (CU1,600 ÷ CU5,400)
Security services (30 months)	2,667	CU4,800 × (CU3,000 ÷ CU5,400)
Maintenance services (24 months)	711	CU4,800 × (CU800 ÷ CU5,400)
Total	4,800	

The SME fulfils the promise to supply the alarm at a point in time at the start of the contract. The SME fulfils the promises to provide security and maintenance services over time and measures progress based on time elapsed.

For the year ended 31 December 2025, the SME restates its comparative results and recognises revenue of CU2,667:

Promise	Revenue recognised	Calculation
	CU	
Alarm system	1,422	
Security services (12 months)	1,067	CU2,667 × (12 months ÷ 30 months)
Maintenance services (6 months)	178	CU711 × (6 months ÷ 24 months)
Total	2,667	

For the year ended 31 December 2026, the SME recognises revenue of CU1,422 ((CU2,667 × (12 months ÷ 30 months)) + (CU711 × (12 months ÷ 24 months)).

For the year ended 31 December 2027, the SME recognises revenue of CU711 ((CU2,667 × (6 months ÷ 30 months)) + (CU711 × (6 months ÷ 24 months)).

In accordance with paragraph A30, the SME discloses in the notes to its financial statements that it has reflected the aggregate effect of all modifications that occurred before 1 January 2026.

If the SME did not use the exemption in paragraph A28(c), the SME would account for the contract modification as if it were a termination of the existing contract and the creation of a new contract in accordance with paragraph 23A.4(a).

A31 An entity retrospectively applying the revised Section 23 shall disclose the amount of the adjustment for each line item affected for the annual period immediately preceding the date of initial application and not earlier comparative periods as required by paragraph 10.13(b).

Educational notes

If an amendment to the Standard has an effect on the current period or any prior period, paragraph 10.13(b) requires an entity to disclose the amount of the adjustment for each affected line item. The adjustment for each affected line item is required for the current period and each prior period presented, to the extent practicable.

Paragraph A3 includes an option that also relieves an entity from disclosing the information required by paragraph 10.13(b) for the current period. The relief means an entity does not have to apply the previous Section 23 to the current period for the purpose of the disclosure.

Paragraph A31 relieves an entity from disclosing the information required by paragraph 10.13(b) for comparative periods presented, other than the comparative period immediately preceding the date of initial application.

Figures 30 and 31 respectively illustrate the relief provided by paragraphs A3 and A31 for entities that present one and two years of comparative information.

Figure 30—Disclosure required by paragraph 10.13(b), entity presents one year of comparative information

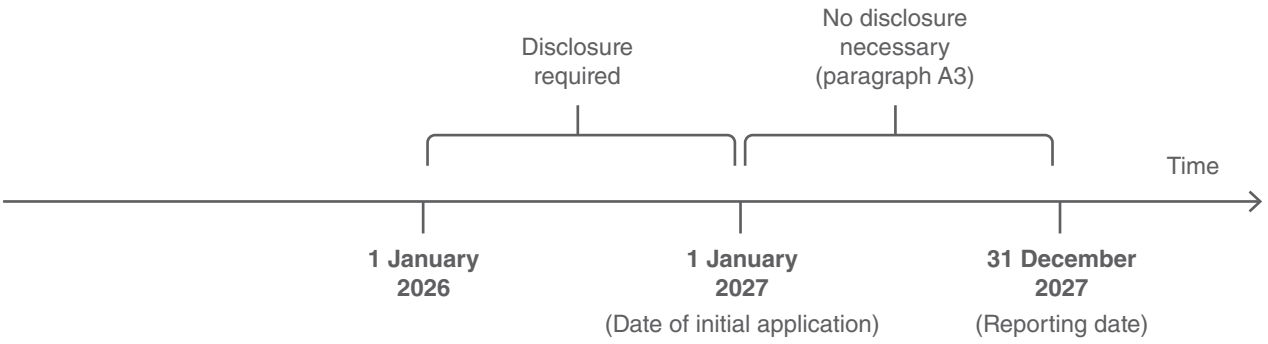
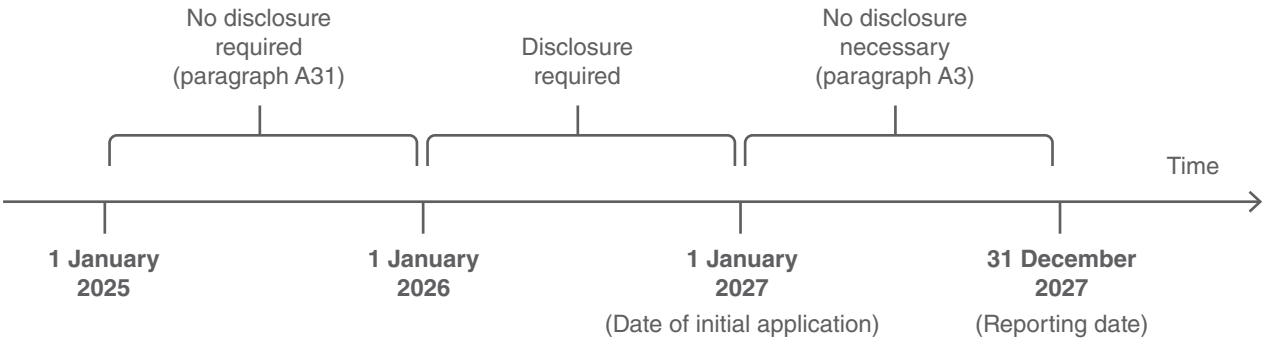


Figure 31—Disclosure required by paragraph 10.13(b), entity presents two years of comparative information



Example—Disclosure, adjustment for each line item affected

Ex 158 An SME provides IT solutions, including software licences.

The SME chooses to retrospectively apply the revised Section 23 for the year ended 31 December 2027. The SME also chooses not to disclose the information required by paragraph 10.13(b) for the current period.

The following disclosure illustrates one way of satisfying the requirements in paragraph 10.13(a)–(b).

SME's financial statements for the year ended 31 December 2027 (extract):

Note 23. Changes in accounting policies

...

Revenue from Contracts with Customers

On transition to the third edition of the *IFRS for SMEs* Accounting Standard, the entity retrospectively applied the revised Section 23 *Revenue from Contracts with Customers*. Applying the section changed the entity's accounting policy for revenue from software licences. Revenue from licences is now recognised evenly over the licence period. Previously, revenue was recognised immediately when the licences were sold.

Impact on the statement of income and retained earnings for the year ended 31 December 2026:

	Original CU	Adjustment CU	Restated CU
Revenue	5,259,341	522,175	5,781,516
Cost of sales	(4,004,000)	–	(4,004,000)
Gross profit	1,255,341	522,175	1,777,516
Operating expenses	(844,483)	–	(844,483)
Profit before tax	410,858	522,175	933,033
Income tax expense	(172,326)	–	(172,326)
Profit for the year	238,532	522,175	760,707
Retained earnings at start of year	1,821,605	(1,036,911)	784,694
Dividends	(80,000)	–	(80,000)
Retained earnings at end of year	1,980,136	(514,736)	1,465,400

Impact on the statement of financial position for the year ended 31 December 2026:

	Original	Adjustment	Restated
	CU	CU	CU
Current liabilities—Contract liabilities	49,879	514,736	564,615
Equity—Retained earnings	1,980,136	(514,736)	1,465,400

Contract assets were previously presented as accrued income. Contract liabilities were previously presented as deferred revenue.

Impact on the statement of cash flows for the year ended 31 December 2026:

	Original	Adjustment	Restated
	CU	CU	CU
Profit for the year	238,532	522,175	760,707
Changes in operating assets and liabilities			
Increase (decrease) in contract liabilities	6,863	(522,175)	(515,312)

Prospective application

A32 If an entity prospectively applies the revised Section 23, the entity shall apply the revised Section 23 to contracts that begin after the date of initial application. The entity shall not change its **accounting policy** for any contracts in progress at that date.

Educational notes

Date of initial application

In accordance with paragraph A2, the date of initial application is the beginning of the reporting period in which an entity first applies the third edition of the Standard. If an entity first applies the third edition of the Standard for the year ended 31 December 2027, the date of initial application is 1 January 2027.

Accounting policy for contracts with customers

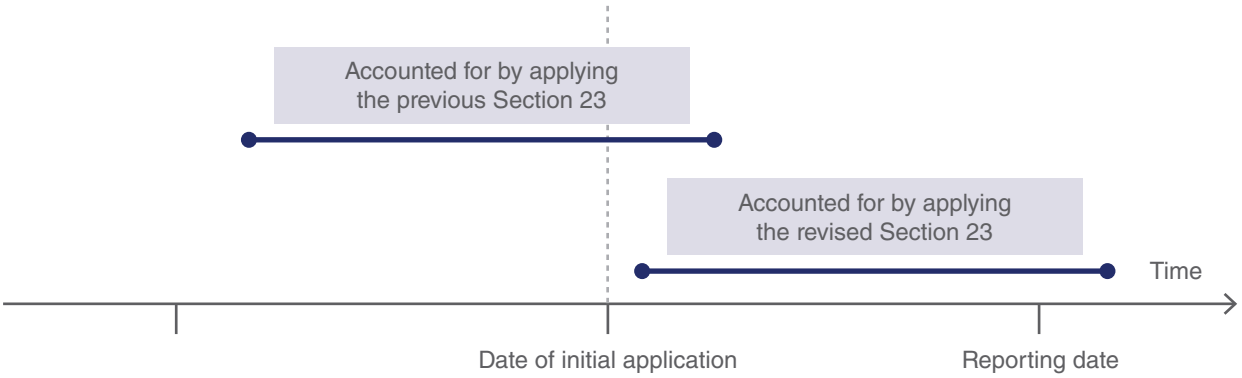
If an entity prospectively applies the revised Section 23, how it accounts for a contract is based on when the contract begins:

- if the contract begins *before* the date of initial application, the entity continues to account for the contract by applying the previous Section 23; and
- if the contract begins *after* the date of initial application, the entity accounts for the contract by applying the revised Section 23.

Consequently, an entity that chooses to prospectively apply the revised Section 23 might apply two accounting policies for revenue in its current period. The entity does not restate comparative information.

Figure 32 shows how an entity accounts for a contract based on when it begins.

Figure 32—Prospective application of the revised Section 23



Example—Accounting policy for contracts with customers

Ex 159 An SME initially applies the third edition of the *IFRS for SMEs* Accounting Standard for the year ended 31 March 2028. The SME chooses to prospectively apply the revised Section 23.

The SME enters into a contract on 1 February 2027 to build an office for Customer A. The SME expects the office to be built, and the contract completed, within 12 months.

The SME enters into a contract on 1 May 2027 to build an office for Customer B. The SME expects the factory to be built, and the contract completed, within 10 months.

The date of initial application is 1 April 2027.

The contract with Customer A begins before the date of initial application. Therefore, the SME accounts for the contract applying the previous Section 23.

The contract with Customer B begins after the date of initial application. Therefore, the SME accounts for the contract applying the revised Section 23.

Therefore, in its financial statements for the year ended 31 March 2028, the SME will apply:

- the previous Section 23 to account for the contract with Customer A; and
- the revised Section 23 to account for the contract with Customer B.

A33 The revised Section 23 amended paragraphs 4.11(b), 11.13, 11.14(a), 17.29, 18.1, 21.1(b), 27.1(f) and 34.16; deleted paragraphs 13.2(a), 13.14 and 21A.5; and added paragraphs 11.7(g), 11.7A, 11.13A–11.13B, 11.14A, 11.49(j), 11.55 and 13.2A. If an entity prospectively applies the revised Section 23, the entity shall apply those amendments in accordance with paragraph A32.

Educational notes

Paragraph A33 lists all the consequential amendments to the Standard arising from the revised Section 23.

When an entity applies the amendments

An entity applies the consequential amendments at the same time it applies the revised Section 23. Consequently:

- if an entity accounts for a contract in accordance with the revised Section 23, the entity also applies the consequential amendments when accounting for that contract; and
- if an entity accounts for a contract in accordance with the previous Section 23, the entity does not apply the consequential amendments when accounting for that contract.

By doing so, a contract is either wholly accounted for in accordance with the second edition of the Standard or the third edition of the Standard, but not a mixture of both.

Amendments unrelated to contracts with customers

A few of the consequential amendments listed in paragraph A33 do not relate to contracts with customers. However, the principle in paragraph A30 would still apply if an entity chooses to prospectively apply the revised Section 23. For example:

- the revised Section 23 amended paragraph 17.29 so an entity applies the revised Section 23 to determine the date of disposal of an item of property, plant and equipment, instead of the previous Section 23. If the entity disposes of the item before the date of initial application, the entity would apply the previous Section 23.
- the revised Section 23 amended paragraph 34.16 so an operator of a service concession arrangement recognises, measures and discloses revenue in accordance with the revised Section 23 for the services it performs, instead of the previous Section 23. If the service concession arrangement begins before the date of initial application, the entity would be expected to continue to apply the previous Section 23. If the service concession arrangement begins after the date of initial application, the entity would apply the revised Section 23.

Example—Applying consequential amendments arising from the revised Section 23

Ex 160 An SME initially applies the third edition of the *IFRS for SMEs* Accounting Standard for the year ended 31 December 2027. The SME chooses to prospectively apply the revised Section 23.

The SME enters into a contract on 1 October 2026 to excavate a site for a customer for CU2,000. The SME requires the customer to pay CU1,000 before the excavation begins and CU1,000 after the site has been inspected and approved as suitable for construction. The site is expected to take 18 months to excavate.

The date of initial application is 1 January 2027.

The contract begins before the date of initial application. Therefore, the SME accounts for the contract applying the previous Section 23 as a construction contract.

The SME recognises the revenue associated with the contract by reference to the stage of completion at the end of the reporting period. On 31 December 2027, the stage of completion of the contract is 90%. The SME recognises revenue of CU1,800 (CU2,000 × 90%) and accrued income of CU800 (CU1,800 – CU1,000).

The revised Section 23 added paragraph 11.7A so an SME applies the impairment requirements in paragraphs 11.21–11.26 to contract assets. Because the contract begins before the date of initial application, the SME does not apply paragraph 11.7A, and therefore does not apply paragraph 11.21–11.26 when assessing the accrued income of CU800 for impairment. Instead, the SME assesses the accrued income for impairment by applying the previous Section 23.

A34 An entity prospectively applying the revised Section 23 shall disclose:

(a) that it has not restated comparative information as a result of applying the revised Section 23; and

(b) the nature of the change in accounting policy.

A35 An entity prospectively applying the revised Section 23 is not required to apply the disclosure requirements in that section to comparative information provided for periods before the date of initial application.

Educational notes

Paragraph A34 includes the information to be disclosed by an entity prospectively applying the revised Section 23 when it initially applies the section. The paragraph does not include the information required by paragraph 10.13(b)–(c) in accordance with paragraph A3, which includes the option not to disclose the information required by these paragraphs.

Contracts in progress at the date of initial application

An entity prospectively applying the revised Section 23 continues to apply the previous Section 23 to contracts that begin before the date of initial application (see paragraph A32). The Standard does not prescribe whether an entity is required to include information about these 'in progress' contracts in the disclosures required by the revised Section 23. The following two disclosures are relevant to an entity's choice about including information about these contracts.

- Paragraphs 23.83–23.84 require an entity to disclose the opening and closing contract balances and revenue recognised in the reporting period that was included in the opening contract liability balance. Although in progress contracts are not accounted for in accordance with the revised Section 23, the entity might have period end balances associated with these contracts that were presented as accrued or deferred income instead of contract assets or liabilities. In many cases, these balances will be similar to those that would be recognised if the in progress contracts were accounted for in accordance with the revised Section 23. If this is likely the case, the entity might include in progress contract balances in the information required by paragraphs 23.83–23.84 so it is more comparable with the information disclosed in future reporting periods.
- Paragraph 23.82 requires an entity to disaggregate revenue from contracts with customers. If an entity excludes information about in progress contracts from the disaggregation, the total disaggregated revenue will not equal the total revenue from contracts with customers recognised in the current period. The difference between the two totals will be the revenue recognised in the current period from the in progress contracts (see paragraph A36(b)). An entity would be expected to explain such a difference in the notes to its financial statements.

A36 In the **financial statements** for periods in which contracts that were in progress at the date of initial application remain in progress, an entity prospectively applying the revised Section 23 shall disclose:

(a) the accounting policy for the recognition of revenue for those contracts, including the methods adopted to determine the stage of completion of transactions involving the rendering of services; and

(b) the revenue recognised in the current period from those contracts.

Educational notes

Financial statements in which disclosure is required

An entity discloses the information required by paragraph A36 in its financial statements for periods in which contracts that were in progress at the date of initial application remain in progress. If all 'in progress' contracts are completed in the period of initial application, the entity would disclose the information in:

- its financial statements for the period of initial application; and
- its financial statements for the subsequent period, as comparative information (see paragraph 3.14).

Information required

An entity continues to apply the previous Section 23 to in progress contracts.

Paragraph A36(a) requires an entity to disclose its accounting policy for the recognition of revenue for those contracts. The requirement is based on the disclosure requirement in the previous Section 23 (see paragraph 23.30 of the second edition of the Standard). Therefore, the information will be similar to the information the entity discloses in its financial statements before transitioning to the third edition of the Standard.

Paragraph A36(b) requires an entity to disclose the amount of revenue recognised from in progress contracts. This will require an entity to separately recognise revenue from these contracts.

Example—Transition disclosures

Ex 161 An SME constructs parts for car manufacturers. The SME initially applies the third edition of the *IFRS for SMEs* Accounting Standard for the year ended 31 December 2027. The SME chooses to prospectively apply the revised Section 23.

The following disclosure illustrates one way of satisfying the requirements in paragraphs A34 and A36.

Notes to the SME's financial statements for the year ended 31 December 2027 (extract):

Note 12. Changes in accounting policies
...
In accordance with the new revenue recognition requirements in the third edition of the *IFRS for SMEs* Accounting Standard, the accounting policy for revenue was changed in 2027.
Previously, revenue from the sale of parts was recognised over the period in which the parts were designed and manufactured using the percentage completion method based on the ratio of costs incurred to date to estimated total costs. Revenue is now recognised when the parts are transferred to the customer on delivery.
The change in accounting policy has been accounted for prospectively and comparative information for 2026 has not been restated. The previous revenue recognition policy was used for contracts entered into before 2027, including those completed in 2027. Revenue of CU18,000 was recognised in 2027 from such contracts.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

The requirements in IFRS 15 *Revenue from Contracts with Customers* and those in Section 23 differ as at February 2025.

The revenue recognition model in Section 23 is based on the same principles as IFRS 15 but is drafted in simpler language and contains less detail.

The main differences relate to:

- *variable consideration*—Section 23 expresses the requirement to constrain estimates of variable consideration in relation to consideration to which the SME will become entitled. IFRS 15 expresses the requirement in relation to revenue reversals that will not occur.
- *time value of money*—Section 23 requires an SME to adjust the promised consideration for the time value of money if payment is deferred and the arrangement constitutes a financing transaction. IFRS 15 requires an entity to adjust the promised consideration if a contract contains a significant financing component, whether from deferred or advance payments.
- *allocation of a discount and variable consideration*—Section 23 requires an SME to allocate a discount or variable consideration to promises using an alternative method if allocating on a relative stand-alone selling price basis does not represent the amount of consideration to which the SME expects to be entitled. IFRS 15 requires an entity to allocate a discount or variable consideration to performance obligations using an alternative method in specified circumstances.
- *costs to obtain a contract*—Section 23 requires an SME to expense the costs of obtaining a contract when the costs are incurred. IFRS 15 requires an entity to recognise the incremental costs of obtaining a contract as an asset if the entity expects to recover those costs.
- *warranties*—Section 23 requires an SME to separately account for a warranty if a customer can choose to buy the good or service without the warranty. IFRS 15 requires an entity to separately account for a warranty based on whether a customer can choose to buy the good or service without the warranty. However, IFRS 15 also requires an entity to separately account for a warranty if the warranty provides the customer with a service in addition to the assurance that a product complies with agreed-upon specifications.
- *customer options for additional goods or services*—Section 23 requires an SME to separately account for customer options only if the SME can do so without undue cost or effort. There is no corresponding exemption in IFRS 15.
- *sales with a right of return*—Section 23 requires an SME to recognise revenue from products sold with a right of return based on the products it expects not to be returned. These requirements are an exception to the general requirements for variable consideration in Section 23. IFRS 15 requires an entity to recognise revenue from products sold with a right of return by applying the requirements for variable consideration.
- *licensing*—Section 23 requires an SME to determine whether a licence of intellectual property transfers to a customer at a point in time or over time by assessing if the SME's activities will or could substantially affect the customer's benefit from the intellectual property. IFRS 15 requires an entity to determine whether a licence transfers at a point in time or over time by assessing if the entity's activities significantly affect the intellectual property and whether the customer is directly exposed to those effects.

- *consideration payable to a customer*—IFRS 15 includes requirements for consideration paid by an entity to a customer. There are no corresponding requirements in Section 23.
- *changes in the transaction price*—IFRS 15 includes requirements for changes in the transaction price, including allocating changes to promises and accounting for changes that occur after a contract modification. Section 23 only includes requirements for changes in the transaction price that occur because of changes in variable consideration.
- *reasonable measures of progress*—IFRS 15 includes requirements if an entity cannot reasonably measure progress towards complete satisfaction of a performance obligation. There are no corresponding requirements in Section 23.
- *non-cash consideration*—IFRS 15 includes requirements for variable non-cash consideration and goods or services contributed by a customer. There are no corresponding requirements in Section 23.
- *customers' unexercised rights*—IFRS 15 includes requirements for customers' unexercised rights (breakage). There are no corresponding requirements in Section 23.
- *repurchase agreements*—IFRS 15 includes requirements for accounting for rights and obligations arising from forwards, call options and put options. Section 23 requires an SME to consider repurchase agreements only when evaluating whether a customer obtains control of an asset. There are no separate requirements for how to account for repurchase agreements in Section 23.
- *consignment and bill-and-hold arrangements*—IFRS 15 includes requirements for consignment and bill-and-hold arrangements. There are no corresponding requirements in Section 23.

The following table lists the disclosure requirements in IFRS 15 and maps them to the similar requirement in Section 23. An 'X' mark is given for disclosure requirements where there is no similar requirement in Section 23.

IFRS 15 paragraph(s)	Section 23 paragraph(s)
110	X
111	X
113(a)	X
113(b)	23.83(b)
114, B89	23.82
115	X
116(a)	23.83(a), 23.84(a)
116(b)	23.84(b)
116(c)	X
117	X

continued ...

IFRS 15 paragraph(s)	Section 23 paragraph(s)
118	X
119	23.85
120	X
121	X
122	X
123(a)	X
123(b)	23.87
124(a)	23.86
124(b)	X
125	X
126(a)	X
126(b)	X
126(c)–(d)	X
127	23.88
128(a)	X
128(b)	23.89
129	X

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements in Section 23 *Revenue from Contracts with Customers* of the *IFRS for SMEs* Accounting Standard by answering the questions provided.

Assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those supplied on page 213.

Mark the box next to the most correct statement.

Question 1

Section 23 applies to:

- ☐ (a) revenue from lease contracts.
- ☐ (b) revenue from contracts not in writing.
- ☐ (c) investment income.
- ☐ (d) none of the above.

Question 2

What would prevent an SME from applying the revenue recognition model in Section 23 to account for a contract with a customer?

- ☐ (a) The contract is not in writing.
- ☐ (b) The customer pays in share options.
- ☐ (c) The customer is not expected to pay the consideration when due.
- ☐ (d) Any of the above.

Question 3

Which of the following facts is irrelevant to an SME's assessment of whether it is required to account for a good and service in a contract separately?

- ☐ (a) The entity prices the good and service in the contract separately.
- ☐ (b) The entity also sells the good and service separately.
- ☐ (c) The entity integrates the good and service.
- ☐ (d) The service customises the good.

Question 4

An SME sells a good with a price of CU1,000 to a customer on 60 days' credit (normal credit terms). The SME offers the customer a prompt settlement discount of 10% if it pays within 30 days of the good being transferred. Of the amount the SME receives from the customer, 20% is sales tax collected on behalf of the national government.

The consideration the entity expects to be entitled to in exchange for transferring the good includes:

- ☐ (a) fixed consideration of CU818 and variable consideration of CU91.
- ☐ (b) fixed consideration of CU700 and variable consideration of CU100.
- ☐ (c) fixed consideration of CU720 and variable consideration of CU80.
- ☐ (d) fixed consideration of CU800 and variable consideration of CU200.

Question 5

How might an SME allocate the transaction price to the promises in a contract?

- ☐ (a) In proportion to the selling price of the goods or services if sold individually.
- ☐ (b) In proportion to a competitor's selling price of the goods or services.
- ☐ (c) In proportion to the forecast costs, plus an appropriate margin, of the goods or services.
- ☐ (d) Any of the above.

Question 6

Which of the following is not an acceptable method for recognising revenue from a promise fulfilled over time?

- ☐ (a) Recognise revenue evenly over time.
- ☐ (b) Recognise revenue when consideration is received from the customer.
- ☐ (c) Recognise revenue based on the ratio of costs incurred to date to estimated total costs.
- ☐ (d) Recognise revenue based on the amount the SME has a right to invoice the customer.

Question 7

Which of the following contract costs would Section 23 require an SME to recognise as an expense as incurred?

- ☐ (a) Costs of fulfilling a contract that has not yet begun.
- ☐ (b) Costs of obtaining a contract.
- ☐ (c) Allocated overhead costs that are explicitly rechargeable to the customer.
- ☐ (d) Costs in the scope of another section of the Standard.

Question 8

An SME enters into a contract with a customer to transfer a storage container and repaint the customer's existing storage container for CU450. The SME accounts for the new container and repainting as separate promises and allocates the transaction price of CU450 between them as follows:

Promise	Allocated transaction price
	CU
New container	300
Repainting	150
Total	450

At the reporting date, the SME has:

- fulfilled its promise to transfer the new container; and
- fulfilled 50% of its promise to repaint the existing container.

The customer paid a CU100 deposit at the start of the contract. The remaining CU350 is due only after the SME has finished the repainting.

At the reporting date, the SME's financial statements include:

- ☐ (a) a contract asset of CU275.
- ☐ (b) a trade receivable of CU275.
- ☐ (c) a contract liability of CU100 and a contract asset of CU375.
- ☐ (d) a contract liability of CU100 and a trade receivable of CU375.

Question 9

An SME enters into a contract to build a three-floor office. The contract includes a performance bonus for on-time completion of the building.

Which of the following changes would not be accounted for as a contract modification?

- ☐ (a) Increasing the contract price because of increases in material costs.
- ☐ (b) Reducing the size of the office because of increases in material costs.
- ☐ (c) A change in the SME's expectation that it will achieve the performance bonus because of delays caused by poor weather.
- ☐ (d) Increasing the allowable time for achieving the performance bonus because of delays caused by poor weather.

Question 10

How an SME accounts for revenue from warranties sold with its products is determined by:

- ☐ (a) whether the warranty is separately priced.
- ☐ (b) whether the customer has the option to purchase the product with or without the warranty.
- ☐ (c) whether the customer will claim under the warranty.
- ☐ (d) whether the warranty provides the customer with a service.

Question 11

Which of the following could result in a customer option that an SME would account for separately?

- ☐ (a) A discount offered to new customers on their first order.
- ☐ (b) A volume discount offered to customers that buy five or more products in a single transaction.
- ☐ (c) A voucher, offered to customers that buy five or more products, which can be redeemed for a free product in their next order.
- ☐ (d) None of the above.

Question 12

An SME that sells goods determines whether it is acting as a principal or agent based on whether it:

- ☐ (a) accepts the order for the goods from the customer.
- ☐ (b) delivers the goods to the customer.
- ☐ (c) controls the goods before they are transferred to the customer.
- ☐ (d) collects the consideration for the goods from the customer.

Question 13

An SME enters into a contract to build a website for an entity that provides legal services. In exchange for building the website, the customer provides the SME with legal advice.

If the SME cannot reasonably estimate the fair value of the legal services, the SME determines the transaction price by measuring the consideration at:

- ☐ (a) the cost to the SME of providing the services to the customer.
- ☐ (b) the stand-alone selling price of the services provided to the customer.
- ☐ (c) the fair value of the services provided to the customer.
- ☐ (d) nil.

Question 14

How is an SME required to account for products sold with a right of return?

- ☐ (a) Recognise revenue and a provision for the best estimate of the amount required to settle any refunds.
- ☐ (b) Recognise revenue when the returns period has expired.
- ☐ (c) Recognise revenue for products expected not to be returned and a liability for products expected to be returned.
- ☐ (d) Recognise revenue for products expected not to be returned, a liability for products expected to be returned and an asset for products expected to be returned.

Question 15

Which promise to grant a licence is most likely to be fulfilled over time?

- ☐ (a) A licence for a music recording.
- ☐ (b) A licence for a digital book.
- ☐ (c) A licence for an image.
- ☐ (d) A licence for franchise rights.

Answers

Q1 (b)—see paragraphs 23.1 and 23.6.

Q2 (c)—see paragraphs 23.6–23.7 and 23A.21.

Q3 (a)—see paragraphs 23.18 and 23.21.

Q4 (c)—see paragraphs 23.23, 23.26 and 23.36.

Calculation:

CU1,000 list price adjusted for sales input tax of 20% = (CU1,000 × (100% – 20%)) = CU800

Variable consideration = CU800 × prompt settlement discount of 10% = CU80

Fixed consideration = CU800 – variable consideration of CU80 = CU720

Q5 (d)—see paragraphs 23.42–23.44.

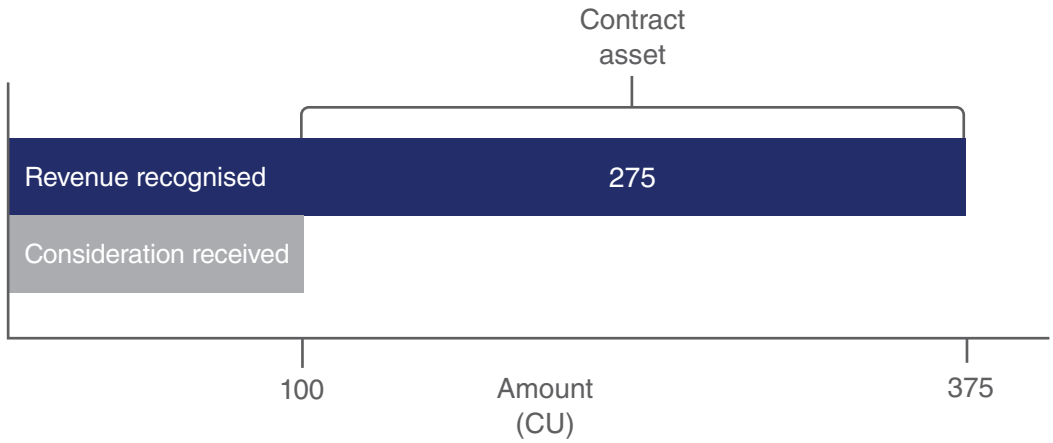
Q6 (b)—see paragraphs 23.65–23.67.

Q7 (b)—see paragraphs 23.68–23.73.

Q8 (a)—see paragraphs 23.78–23.79.

Calculation:

Revenue recognised = CU300 + (CU150 × 50%) = CU375



Q9 (c)—see paragraph 23A.2.

Q10 (b)—see paragraphs 23A.5–23A.7.

Q11 (c)—see paragraphs 23A.8–23A.9.

Q12 (c)—see paragraph 23A.15.

Q13 (b)—see paragraph 23A.22.

Q14 (d)—see paragraph 23A.24.

Q15 (d)—see paragraphs 23A.30–23A.35.

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements in Section 23 *Revenue from Contracts with Customers* in accordance with the *IFRS for SMEs* Accounting Standard by completing the case studies provided.

Once you have completed a case study, check your answers against those on pages 215–219 for Case study 1 and pages 221–225 for Case study 2.

The answers to the case studies illustrate how an SME might apply the requirements in Section 23 based on the limited facts presented. The answers are not intended to represent the only way an SME might apply the requirements. Other outcomes might be permissible depending on the judgements made by the SME and considering all relevant facts and circumstances.

Case study 1

SME A entered into a contract with a customer to supply and install a machine on 1 July 20X1 and to maintain the machine each month until June 20X2.

Customers are able to purchase the machine without the maintenance plan but are unable to purchase the machine without installation. Maintenance plans are also available for customers who purchased their machines elsewhere. The installation is not complex and is capable of being performed by other entities. The process of installing the machine does not customise or modify it.

The customer is contractually obliged to pay SME A CU200,000 on 1 July 20X2. Normal credit terms in the industry are 30 days.

The prevailing interest rate for one year's credit granted to trade customers in the industry is 12% a year.

SME A buys the machine from the manufacturer for CU92,000. Installing the machine is expected to cost SME A CU20,000. When SME A sells and installs machinery as a separate transaction, it earns a margin of 25% on cost.

Experience has shown that maintaining a machine of the model sold to the customer is expected to cost SME A CU40,000 over the course of the year. When SME A provides maintenance services to customers in a separate transaction, it earns a margin of 50% on cost.

SME A is not required to collect any sales taxes.

Part A—Identify the promises in SME A's contract with the customer.

Part B—Determine the transaction price and allocate it to each promise.

Part C—Determine whether each promise is fulfilled over time or at a point in time.

Part D—Prepare accounting entries for SME A to record the revenue for the year ended 31 December 20X1 and year ended 31 December 20X2.

Part E—Draft an extract showing how revenue could be presented and disclosed in SME A's financial statements for the year ended 31 December 20X2.

Answer to Case study 1

Part A

On 1 July 20X1, SME A entered into a single contract for one good (the machine) and two services (installing the machine and maintaining the machine).

Maintaining the machine requires SME A to provide a service each month. Each month of service is distinct. Even though the activities that SME A will provide will vary from month to month, the nature of the overall service remains the same. SME A accounts for the maintenance as a single promise because the service SME provides each month is essentially the same, and:

- each service meets the criterion in paragraph 23.54(a) to be a promise fulfilled over time; and
- SME A would use the same method to measure its progress in transferring control of each service (a time-based measure of progress).

SME A determines the machine and installation are distinct. Because the installation service is capable of being performed by other entities, the customer can benefit from the machine without it being installed by SME A. The factors in paragraph 23.21 also suggest the obligation to install the machine is separate from the obligation to transfer the machine. This is because:

- SME A does not combine the machine and installation in a way that transforms them into a combined output;
- neither the machine nor the installation modify or customise the other; and
- SME A would be able to fulfil its promise to transfer the machine independently of its promise to provide the installation services.

SME A also determines the machine and maintenance are distinct. This is because the customer can benefit from the machine without the maintenance. Consequently, SME A identifies three promises in the contract:

- a promise to transfer the machine;
- a promise to install the machine; and
- a promise to maintain the machine for 12 months.

Part B

Determine the transaction price

The transaction price is determined at the beginning of the contract (1 July 20X1).

Payment of CU200,000 is due on 1 July 20X2: one year from when SME A transfers and installs the machine, and after the SME has maintained the machine. Because payment is beyond normal business terms for transferring, installing and maintaining a machine, SME A determines that the arrangement constitutes a financing transaction.

SME A expects the customer to pay for the machine and installation one year after they are transferred. Therefore, SME A cannot apply the option in paragraph 23.38 and is required to discount the promised amount of consideration for the machine and installation. However, SME A expects each month of maintenance services to be paid less than one year after they have been provided. Therefore, SME A chooses to apply the option in paragraph 23.38 and not discount the promised amount of consideration for the maintenance services.

Consequently, SME A discounts the promised consideration for the machine and installation and recognises the difference between the promised consideration and the discounted value of that amount as interest revenue in accordance with the effective interest method.

For the purpose of this calculation, SME A determines the promised consideration for the machine and installation and the promised consideration for the maintenance based on the price that it would sell them separately:

- the machine and installation would be sold for CU140,000 ((CU92,000 + CU20,000) × (100% + 25%)); and
- the maintenance services would be sold for CU60,000 (CU40,000 × (100% + 50%)).

Therefore, the total of the separate selling prices is equal to the gross amount of consideration of CU200,000 (CU140,000 + CU60,000).

The SME discounts the promised consideration for the machine and installation at 12%, that is, the prevailing market rate of interest for a similar receivable. The discounted promised consideration is calculated at CU125,000 (CU140,000 ÷ (100% + 12%)).

Consequently, the transaction price is CU185,000 (CU125,000 + CU60,000).

Allocate the transaction price

SME A allocates the transaction price on a relative stand-alone selling price basis.

SME A estimates the stand-alone selling price for the goods and services based on their expected cost plus the typical margin earned by the entity as follows:

Promise	Expected costs	Margin	Stand-alone selling price	Calculation
	CU		CU	
Machine	92,000	25%	115,000	CU92,000 × 125%
Installation	20,000	25%	25,000	CU20,000 × 125%
Maintenance	40,000	50%	60,000	CU40,000 × 150%
		Total	200,000	

The difference of CU15,000 between the transaction price (CU185,000) and the sum of the stand-alone selling prices (CU200,000) arises from discounting the consideration for the machine and installation. Because this discount relates to this good and service, SME A allocates the discount to them as follows:

Promise	Allocated transaction price	Calculation
	CU	
Machine	102,679	(CU200,000 × (CU115,000 ÷ CU200,000)) – (CU15,000 × (CU115,000 ÷ CU140,000))
Installation	22,321	(CU200,000 × (CU25,000 ÷ CU200,000)) – (CU15,000 × (CU25,000 ÷ CU140,000))
Maintenance	60,000	
Total	185,000	

Part C

SME A determines that the promise to transfer the machine is fulfilled at a point in time. The promise does not meet the criteria in paragraph 23.54 because:

- the benefits from SME A's performance in transferring the machine are not immediately used by the customer as the machine is transferred. The customer will use the benefits only once the machine is transferred.
- SME A does not manufacture the machine.
- SME A could easily sell the machine to another customer.

SME A determines that the promise to install and maintain the machine is fulfilled over time. The promises are fulfilled over time because the customer benefits from the installation and maintenance as they are performed, and the customer controls the machine as SME A installs and services it.

Part D

1 July 20X1

Dr	Receivable	CU125,000	
	Cr Revenue from contracts with customers		CU125,000

To recognise revenue from the sale and installation of the machine.

1 July 20X1 to 31 December 20X1

SME A might make monthly entries for the recognition of revenue from providing maintenance services and interest revenue, but here they are aggregated into a single entry for the six months.

Dr	Receivable	CU7,289	
	Cr Interest revenue		CU7,289[(a)]

To recognise interest revenue.

Dr	Receivable	CU30,000	
	Cr Revenue from contracts with customers		CU30,000[(b)]

To recognise revenue from providing maintenance services.

1 January 20X2 to 30 June 20X2

SME A might make monthly entries for the recognition of revenue from providing maintenance services and interest revenue, but here they are aggregated into a single entry for the six months.

Dr	Receivable	CU7,711	
	Cr Interest revenue		CU7,711[(c)]

To recognise interest revenue.

Dr	Receivable	CU30,000	
	Cr Revenue from contracts with customers		CU30,000[(d)]

To recognise revenue from providing maintenance services.

1 July 20X2

Dr	Cash	CU200,000	
	Cr Receivable		CU200,000

To recognise the receipt of cash from the customer.

Calculations

(a) Monthly rate of interest = $(1 + \text{annual rate of interest})^{(1 \div 12)} - 1$
$0.949\% = (1 + 0.12)^{(1 \div 12)} - 1$
Interest from 1 July 20X1 to 31 December 20X1 = $(\text{principal amount} \times (1 + \text{monthly rate of interest})^{\text{number of months}}) - \text{principal amount}$
$CU7{,}289 = (CU125{,}000 \times (1 + 0.00949)^{6}) - CU125{,}000$

(b) Revenue from providing maintenance services from 1 July 20X1 to 31 December 20X1 = (transaction price allocated to promise ÷ number of months in contract) × number of months
$CU30{,}000 = (CU60{,}000 \div 12) \times 6$

(c) Interest from 1 January 20X2 to 30 June 20X2 = total interest – interest from 1 July 20X1 to 31 December 20X1
$CU7{,}711 = (CU125{,}000 \times 12\%) - CU7{,}289$

(d) Revenue from providing maintenance services from 1 July 20X1 to 31 December 20X1 = (transaction price allocated to promise ÷ number of months in contract) × number of months
$CU30{,}000 = (CU60{,}000 \div 12) \times 6$

Part E

Notes to SME A's financial statements for the year ended 31 December 20X2 (extract):

Note 2. Accounting policies

...

Revenue

Revenue is measured at the amount of consideration SME A expects to be entitled to for transferring, installing and maintaining machines. If a machine is purchased with a 12-month maintenance plan, payment is due after the maintenance plan has ended. Consequently, payment is deferred beyond normal business terms. Interest revenue is recognised separately on the sale and installation of the machine as the interest accrues using the effective interest method. No interest revenue is recognised separately for the maintenance of the machine because the customer is expected to pay for it within one year of it being provided.

Revenue from the sale and installation of machines is recognised when the customer has accepted delivery of the machine and inspected its installation. No right of return exists on the sale of machines.

Revenue from machine maintenance services is recognised evenly over the period in which the service is provided.

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Note 3. Revenue

	20X2 CU	20X1 CU
Sale of machines	–	125,000
Provision of machine maintenance services	30,000	30,000
Total revenue	30,000	155,000

Note 6. Other income

	20X2 CU	20X1 CU
...		
Interest revenue	7,711	7,289
...		

Case study 2

In January 20X1, SME B entered into a contract to construct a luxury yacht for a customer. The customer specified major structural elements of the yacht, customising the exterior and interior layout design.

At the start of the contract, SME B expected the yacht to take five years to complete. The customer agreed to pay SME B CU2,000,000 by making quarterly payments of CU100,000 over five years. If the customer does not make these payments, SME B has an enforceable right to payment for its work done to date for its costs plus a 30% margin. The customer also agreed to pay SME B a bonus of CU250,000 if the yacht was complete by 30 June 20X5.

On 1 January 20X3, SME B and the customer agreed a change to the yacht's design by adding a swim platform for an additional CU600,000. This increased the remaining quarterly payment from CU100,000 to CU150,000, and expected costs by CU500,000.

The total consideration billed and paid each year is as follows:

	Years ended				
	31/12/20X1	**31/12/20X2**	**31/12/20X3**	**31/12/20X4**	**31/12/20X5**
	CU	**CU**	**CU**	**CU**	**CU**
Billed in the year	400,000	400,000	600,000	600,000	600,000
Paid in the year	400,000	400,000	600,000	600,000	600,000
Outstanding	–	–	–	–	–

At the start of the contract, SME B concludes it to be highly probable that it will complete the yacht by 30 June 20X5. However, following a series of delays in 20X4 caused by constructing the swim platform, SME B concludes it to be highly unlikely it will complete the yacht by this date.

SME B measures its progress based on the ratio of costs incurred to date to estimated total costs. All costs incurred during the year relate to SME B's work to date.

The cumulative costs and total expected costs for each year are as follows:

	Years ended				
	31/12/20X1	**31/12/20X2**	**31/12/20X3**	**31/12/20X4**	**31/12/20X5**
	CU	**CU**	**CU**	**CU**	**CU**
Cumulative costs incurred to date	100,000	500,000	1,250,000	1,600,000	2,000,000
Expected costs to complete	1,400,000	1,000,000	750,000	400,000	–
Total expected costs	1,500,000	1,500,000	2,000,000	2,000,000	2,000,000

Prepare accounting entries for SME B to record the information set out above for the years ended 31 December 20X1–20X5.

Answer to Case study 2

Year to 31 December 20X1

The contract requires SME B to transfer many different goods and services that the customer could benefit from individually. However, none of the obligations to transfer the goods or services are separate because they are integrated by SME B and transformed into a combined output: the yacht. Therefore, SME B accounts for the construction of the yacht as a single promise.

Because SME B concludes it to be highly probable it will complete the yacht by 30 June 20X5 and be entitled to the bonus of CU250,000, it includes the whole amount in the transaction price. Therefore, the transaction price comprises:

	CU
Fixed consideration	2,000,000
Variable consideration	250,000
Transaction price	2,250,000

Because the yacht is highly customised, it cannot be easily redirected to another customer. The customer is obliged to pay SME B for work done to date. Therefore, the promise meets the criterion in paragraph 23.54(c) and is fulfilled over time.

The costs SME B has incurred fulfilling the contract during the year relate to its past performance. Therefore, SME B recognises the costs as an expense.

Journals

Dr	Cash		CU400,000	
	Cr	Revenue		CU150,000[(a)]
	Cr	Contract liability		CU250,000
To recognise payments received and revenue recognised in 20X1.				
Dr	Cost of sales		CU100,000[(b)]	
	Cr	Cash		CU100,000
To recognise costs incurred in 20X1.				

Calculations

(a) Revenue in 20X1 = transaction price × measure of progress
CU150,000 = CU2,250,000 × [CU100,000 (cumulative costs incurred to date) ÷ CU1,500,000 (total expected costs)]

(b) Costs of sales in 20X1 = CU100,000 (costs incurred in 20X1)

Year to 31 December 20X2

Journals

Dr	Cash	CU400,000	
Dr	Contract liability	CU200,000	
	Cr Revenue		CU600,000[(c)]

To recognise payments received and revenue recognised in 20X2.

Dr	Cost of sales	CU400,000[(d)]	
	Cr Cash		CU400,000

To recognise costs incurred in 20X2.

Calculations

(c) Revenue in 20X2 = transaction price × measure of progress – revenue in 20X1
CU600,000 = CU2,250,000 × [CU500,000 (cumulative costs incurred to date) ÷ CU1,500,000 (total expected costs)] – CU150,000[(a)]

(d) Cost of sales in 20X2 = cumulative costs incurred to date – costs incurred in 20X1
CU400,000 = CU500,000 – CU100,000[(b)]

1 January 20X3

The agreement between SME B and the customer to add the swim platform is a contract modification because it changes the scope of the contract. The swim platform is part of the promise to construct the yacht because it is an enhancement of the original design integrated into the construction of the yacht. Therefore, SME B accounts for the modification as if it were part of the original contract and recognises a 'catch-up' adjustment.

Journal

Dr	Revenue	CU37,500[(e)]	
	Cr Contract liability		CU37,500

To recognise the reduction in revenue from the contract modification.

Calculations

(e) Adjustment calculated as the difference between:

- the cumulative revenue recognised at the date of the contract modification based on the original contract (CU150,000[(a)] (revenue in 20X1) + CU600,000[(c)] (revenue in 20X2) = CU750,000); and
- the cumulative revenue recognised at the date of the contract modification based on the revised contract (revised transaction price × measure of progress = CU2,850,000 × [CU500,000 (cumulative costs incurred to date) ÷ CU2,000,000 (revised total expected costs)] = CU712,500).

Therefore, SME B recognises a reduction to revenue of CU37,500 (CU750,000 – CU712,500) at the date of the contract modification.

Year to 31 December 20X3

Journals

Dr	Cash		CU600,000	
Dr	Contract liability		CU87,500	
Dr	Receivable		CU381,250[f]	
	Cr	Revenue		CU1,068,750[g]

To recognise payments received and revenue recognised in 20X3.

Dr	Cost of sales		CU750,000[h]	
	Cr	Cash		CU750,000

To recognise costs incurred in 20X3.

Calculations

(f) The contract liability balance at 1 January 20X3 is CU87,500 and the movement in the year is CU468,750 (revenue in 20X3 CU1,068,750[g] – cash received in 20X3 CU600,000). Therefore, SME B recognises a receivable of CU381,250 (CU468,750 – CU87,500) at 31 December 20X3.

(g) Revenue in 20X3 = transaction price × measure of progress – cumulative revenue recognised in 20X1 and 20X2
CU1,068,750 = CU2,850,000 × [CU1,250,000 (cumulative costs incurred to date) ÷ CU2,000,000 (total expected costs)] – CU150,000[a] – CU600,000[c] + CU37,500[e]

(h) Cost of sales in 20X3 = cumulative costs incurred to date – cumulative costs incurred in 20X1 and 20X2
CU750,000 = CU1,250,000 – CU100,000[b] – CU400,000[d]

Year to 31 December 20X4

Because SME B concludes it to be highly unlikely that it will complete the yacht by 30 June 20X5 and be entitled to the bonus of CU250,000, it includes none of this amount in the transaction price. Therefore, the transaction price comprises:

	CU
Original consideration	2,000,000
Adjustment to revenue from contract modification	600,000
Transaction price	2,600,000

Journals

Dr	Cash		CU600,000	
	Cr	Revenue		CU298,750[(i)]
	Cr	Receivable		CU301,250

To recognise payments received and revenue recognised in 20X4.

Dr	Cost of sales		CU350,000[(j)]	
	Cr	Cash		CU350,000

To recognise costs incurred in 20X4.

Calculations

(i) Revenue in 20X4 = transaction price × measure of progress – cumulative revenue recognised in 20X1, 20X2 and 20X3
CU298,750 = CU2,600,000 × [CU1,600,000 (cumulative costs incurred to date) ÷ CU2,000,000 (total expected costs)] – CU150,000[(a)] – CU600,000[(c)] + CU37,500[(e)] – CU1,068,750[(g)]

(j) Costs of sales in 20X4 = cumulative costs incurred to date – cumulative costs incurred in 20X1, 20X2 and 20X3
CU350,000 = CU1,600,000 – CU100,000[(b)] – CU400,000[(d)] – CU750,000[(h)]

Year to 31 December 20X5

Journals

Dr	Cash		CU600,000	
	Cr	Revenue		CU520,000[k]
	Cr	Receivable		CU80,000

To recognise payments received and revenue recognised in 20X5.

Dr	Cost of sales		CU400,000[l]	
	Cr	Cash		CU400,000

To recognise costs incurred in 20X5.

Calculations

(k) Revenue in 20X5 = transaction price × measure of progress – cumulative revenue recognised in 20X1, 20X2, 20X3 and 20X4
CU520,000 = CU2,600,000 × [CU2,000,000 (cumulative costs incurred to date) ÷ CU2,000,000 (total expected costs)] – CU150,000[a] – CU600,000[c] + CU37,500[e] – CU1,068,750[g] – CU298,750[i]

(l) Cost of sales in 20X5 = cumulative costs incurred to date – cumulative costs incurred in 20X1, 20X2, 20X3 and 20X4
CU400,000 = CU2,000,000 – CU100,000 – CU400,000[d] – CU750,000[g] – CU350,000[j]

Summary of financial performance

	Years ended				
	31/12/20X1	**31/12/20X2**	**31/12/20X3**	**31/12/20X4**	**31/12/20X5**
	CU	**CU**	**CU**	**CU**	**CU**
Revenue	150,000[a]	600,000[c]	1,031,250[e]+[g]	298,750[i]	520,000[l]
Expenses	(100,000)[b]	(400,000)[d]	(750,000)[h]	(350,000)[j]	(400,000)[k]
Profit (loss)	50,000	200,000	281,250	(51,250)	120,000

Summary of financial position

	As at				
	31/12/20X1	**31/12/20X2**	**31/12/20X3**	**31/12/20X4**	**31/12/20X5**
	CU	**CU**	**CU**	**CU**	**CU**
Cumulative revenue	150,000	750,000	1,781,250	2,080,000	2,600,000
Cumulative billings	(400,000)	(800,000)	(1,400,000)	(2,000,000)	(2,600,000)
Receivable (contract liability)	(250,000)	(50,000)	381,250	80,000	–

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