Guidance for AASB 15
Revenue from Contracts with Customers

15 December 2017
Guidance for AASB 15 Revenue from contracts with customers

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1. **Overview**

1.1 **Objective**

AASB 15 *Revenue from Contracts with Customers* (AASB 15) is effective for NSW for-profit public sector agencies from FY2018/19 and a year later (i.e. FY 2019/20) for the not-for-profit (NFP) agencies. The key objectives are:

- A more robust framework to address revenue recognition issues
- Streamline and reduce the volume of the relevant standards and interpretations
- More useful information to users through expanded disclosures

AASB 2016-3 *Amendments to Australian Accounting Standards – Clarifications to AASB 15* (AASB 2016-3) was subsequently published to clarify some concepts to AASB 15 and provide further practical expedients on transition to AASB 15.

AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* (AASB 2016-8) was published to include an appendix to AASB 15 on implementation guidance for NFP entities. This implementation guidance for the NFP entities has been incorporated in this document in grey shaded text.

This Treasury guidance provides an overview of the requirements of AASB 15 including disclosures and practical transitional impacts. However, agencies still need to review AASB 15 in detail to ensure they understand its requirements.

Agencies should review the illustrative examples in IFRS 15 *Revenue from Contracts with Customers* (IFRS 15) to understand the application of AASB 15 to particular aspects of a contract with a customer. The illustrative examples are not part of AASB 15 but available in AASB’s website [http://www.aasb.gov.au/admin/file/content105/c9/IFRS15_IE_5-14.pdf](http://www.aasb.gov.au/admin/file/content105/c9/IFRS15_IE_5-14.pdf)

IFRS references are used in this guidance to draw attention to the ‘basis of conclusions’ on IFRS 15. Also refer to the clarification issued in April 2016 on some of the ‘basis of conclusions’ on IFRS 15.

1.2 **Main impact**

Currently, revenue transactions are often separated into components that are accounted for under different revenue standards and interpretations. This is no longer the case as AASB 15 provides a single framework for revenue recognition using a five-step model.

AASB 15 replaces the following:

- AASB 111 Construction Contracts (AASB 111)
- AASB 118 Revenue (AASB 118)
- Interpretation 13 Customer Loyalty Programmes
- Interpretation 15 Agreements for the Construction of Real Estate
- Interpretation 18 Transfers of Assets from Customers
- Interpretation 131 Revenue – Barter Transactions Involving Advertising Services
- Interpretation 1042 Subscriber Acquisition Costs in the Telecommunications Industry.
Key changes

- AASB 15 is principles-based and provides substantial application guidance. AASB 15 extensively discusses various revenue recognition topics with examples.
- Revenue recognition is now based on when control of the goods or services transfer to the customer. Under AASB 118, recognition was based on when risks and rewards transferred. Risks and rewards are retained as an indicator of the transfer of control, but not the only indicator.
- There is more specific guidance on identifying performance obligations in a contract, compared to existing pronouncements.
- Revenue recognition may be accelerated or deferred, compared to existing pronouncements. In particular for revenue contracts with multiple components, variable consideration, and licences.
- Interest and dividend income are excluded from the scope of AASB 15 and moved to AASB 9 Financial Instruments.
- There are significant additional disclosure requirements to provide more useful information to financial statement users.

AASB 15 primarily aims to be a single comprehensive revenue recognition framework, with a clearly explained revenue recognition approach and elaborate guidance on various revenue streams.

While these changes are significant, entities having revenue transactions with complex features like multiple deliverables (i.e. bundled goods and services), variable selling prices (including rebates, discounts, etc.), non-standard contract clauses etc. are most likely to be impacted.

Therefore, there may be a limited impact for many NSW public sector entities, especially NFP entities. However this can only be determined through a review of revenue contracts.

1.3 Scope

An entity should apply AASB 15 to all contracts with customers, except (AASB 15.5):

- lease contracts;
- insurance contracts;
- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers; and
- financial instruments and other contractual rights or obligations within the scope of AASB 9 Financial Instruments, AASB 10 Consolidated Financial Statements, AASB 11 Joint Arrangements, AASB 127 Separate Financial Statements and AASB 128 Investments in Associates and Joint Ventures.
2. **Key Considerations**

2.1 **Comprehensive revenue recognition model**

AASB 15 describes the principles to be applied in measuring and recognising revenue and the related cash flows from contracts with customers. The core principle is that an entity will recognise revenue at an amount that reflects the consideration entitled in exchange for transferring goods or services to a customer.

AASB 15 provides a new comprehensive framework for revenue recognition and measurement using the following five-step model:

**Five step revenue recognition model**

1. **Step 1** Identify the contract with the customer
2. **Step 2** Identify the performance obligations in the contract
3. **Step 3** Determine the transaction price
4. **Step 4** Allocate the transaction price to each performance obligation
5. **Step 5** Recognise revenue when (or as) performance obligations are satisfied

2.2 **Interaction with other standards**

A contract with a customer may partially be in scope of AASB 15 and partially within the scope of other Standards, e.g. a contract for the lease of an asset and maintenance of the leased equipment.

In such instances, an entity must first apply the other standards if those standards specify how to separate and/or initially measure one or more parts of the contract. The entity will then apply AASB 15 to the remaining components of the contract (AASB 15.7).

For example - If a contract includes a financial instrument (e.g. financial guarantee) and a revenue component, the fair value of the financial instrument is first measured under AASB 9 *Financial Instruments* and the balance contract consideration is allocated in accordance with AASB 15.

Transactions that fall within the scope of multiple standards should be separated into components, so that each component can be accounted for under the relevant standards. This is demonstrated in the decision tree below.
2.3 Portfolio approach

AASB 15 is generally applied to an individual contract with a customer. However, as a practical expedient, an entity may apply AASB 15 to a portfolio of contracts (or performance obligations) with similar characteristics, if the impact of such portfolio application is not materially different compared to application by individual contracts (AASB 15.4).

When accounting for a portfolio, an entity should use estimates and assumptions that reflect the size and composition of the portfolio. The portfolio approach can be applied to both contract revenue and costs.

Agencies should refer to illustrative example No.22 (IFRS 15.IE110-IE115) on portfolio application.
2.4 Contract costs

AASB 15 provides guidance on accounting for the incremental costs of obtaining a contract with a customer and costs to fulfil a contract.

**Incremental costs of obtaining a contract**

Incremental costs of obtaining a contract are costs that would not otherwise have been incurred, and will include costs such as sales commissions, legal fees, travel costs, employee compensation solely tied to specific contracts etc.

An entity should recognise incremental costs incurred to obtain a contract as assets (i.e. contract assets) if it expects to recover these costs (AASB 15.91). These assets are then amortised on a basis consistent with the transfer of goods or services to the customer (AASB 15.99).

There is a practical expedient if the amortisation period of the asset is one year or less. In this case the cost can be expensed immediately (AASB 15.94).

Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained should be expensed when incurred, unless those costs are explicitly chargeable to the customer (AASB 15.93).

**Costs to fulfil a contract**

If costs incurred in fulfilling a contract are in the scope of another Standard, that Standard is applied (e.g. inventory, intangibles or property, plant and equipment). If another Standard does not apply, then a contract asset is recognised only if the fulfilment costs (AASB 15.95):

- relate directly to an existing contract or specific anticipated contract;
- generate or enhance resources of the entity that will be used to satisfy the performance obligations in the future; and
- the costs are expected to be recovered.

These assets are then amortised on a basis consistent with the transfer of goods or services to the customer (AASB 15.99).

If the costs do not meet the capitalisation criteria, then they should be expensed as incurred.

<table>
<thead>
<tr>
<th>Costs that may be recognised as asset (AASB 15.97)</th>
<th>Costs expensed as incurred (AASB 15.98)</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ direct labour (e.g. salary and wages)</td>
<td>▪ general and administrative costs, unless explicitly chargeable to the customer</td>
</tr>
<tr>
<td>▪ direct materials (e.g. supplies)</td>
<td>▪ costs of wasted materials, labour or other resources not reflected in the contract price</td>
</tr>
<tr>
<td>▪ allocated costs (e.g. depreciation, insurance, contract management costs)</td>
<td>▪ costs relating to satisfied performance obligations (or partially satisfied performance obligations) in the contract, i.e. costs relating to past performance</td>
</tr>
<tr>
<td>▪ costs explicitly chargeable to the customer</td>
<td>▪ costs that do not clearly relate to unsatisfied or partially satisfied performance obligations</td>
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<tr>
<td>▪ other direct costs incurred only because of the contract (e.g. payments to subcontractors)</td>
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</tbody>
</table>
3. **Five step revenue recognition model**

Agencies should apply a five step model to determine the timing and quantum of revenue to be recognised. The core principle (see Section 2.1 above) is to recognise revenue that reflects the consideration entitled for transferring goods or services.

The model:
- introduces key aspects like customer, enforceable contract, performance obligations, transaction price and price allocation; and
- prescribes the ground rules in evaluating the above aspects to help achieve the core principle.

Under the model revenue is recognised when (or as) an entity transfers control of goods or services to a customer (AASB 15.31) at an amount which the entity is entitled to (AASB 15.47). Specifically, revenue is recognised:
- over time, in a manner that depicts the entity’s performance obligations (AASB 15.35-37); or
- at a point in time, when the control of the goods or services is transferred to the customer (AASB 15.38)

### 3.1 Step 1 - Identify the contract with the customer

The first step in applying AASB 15 is to determine if a contract exists and whether the contract meets all the criteria to be in the scope of AASB 15. This assessment is made on a contract-by-contract basis, although as a practical expedient an entity may apply this guidance to a portfolio of similar contracts (see Section 3.1.5).

**Table 1 – Summary of key considerations for Step 1**

The following sections discuss and expand on the key criteria a contract must meet to be in the scope of AASB 15. There are also sections on specific circumstances.

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<thead>
<tr>
<th>Section</th>
<th>Topic</th>
<th>Description of Section Contents</th>
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</thead>
<tbody>
<tr>
<td>3.1.1</td>
<td>Contract criteria</td>
<td>This section addresses the central requirements that:</td>
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<tr>
<td></td>
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<td>• there is a contract with a customer; and</td>
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<tr>
<td></td>
<td></td>
<td>• the contract meets certain criteria to be in the scope of AASB 15</td>
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<tr>
<td>3.1.2</td>
<td>Enforceability</td>
<td>This section discusses what an enforceable contact is.</td>
</tr>
<tr>
<td>3.1.3</td>
<td>Contract term</td>
<td>AASB 15 is applied to the duration of the contract.</td>
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<tr>
<td>3.1.4</td>
<td>Collectability</td>
<td>The assessment of a customer’s credit risk is important in determining whether a contract is valid.</td>
</tr>
<tr>
<td>3.1.5</td>
<td>Combined contracts</td>
<td>In certain circumstances AASB 15 requires two or more contracts to be treated as a single contract.</td>
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<tr>
<td>3.1.6</td>
<td>NFP considerations</td>
<td>This section discusses the following contract considerations from a not-for-profit perspective:</td>
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<tr>
<td></td>
<td></td>
<td>• Identifying the customer</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Enforceability</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• The concept of commercial substance</td>
</tr>
</tbody>
</table>
3.1.1 Contract criteria

A contract is an agreement between two or more parties that creates enforceable rights and obligations (AASB 15 Appendix A Defined Terms).

An entity should account for a contract with a customer under AASB 15 if all of the following criteria are met (AASB 15.9):

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations
(b) the entity can identify each party’s rights regarding 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 (i.e. the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract)
(e) it is probable that the entity will collect the consideration entitled in exchange for the underlying goods or services.

If a contract meets the above criteria at inception, an entity should not reassess those criteria unless there is an indication of a significant change in facts and circumstances e.g. deterioration in credit quality (AASB 15.13).

If a contract does not meet the above criteria, the entity should recognise the consideration received as revenue only when (AASB 15.15):

- the entity has no remaining obligations, receives all or substantial consideration which is non-refundable; or
- the contract has been terminated and the consideration received is non-refundable.

3.1.2 Enforceability

Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity’s customary business practices. The practices and processes for establishing contracts vary within and across entities, industries and jurisdictions (AASB 15.10).

3.1.3 Contract term

AASB 15 is applied to the duration of the contract.

Some contracts may have no fixed duration and can be terminated or modified by either party at any time. Other contracts may automatically renew on a periodic basis specified in the contract. The duration of the contract is the contractual period in which the parties to the contract have present enforceable rights and obligations (AASB 15.11).

A contract does not exist under AASB 15 if each party to the contract has unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party. A contract is wholly unperformed if (AASB 15.12):

- the entity has not yet transferred any promised goods or services to the customer
- the entity has not yet received, and is not yet entitled to receive, any consideration in exchange for promised goods or services.
3.1.4 Collectability

The assessment of a customer’s credit risk is an important part of determining whether a contract is valid (IFRS 15.BC42). In evaluating whether collectability of an amount of consideration is probable, an entity should consider only the customer’s ability and intention to pay that amount of consideration when it is due [AASB 15.9(e)].

Example – collectability

An entity licences an intellectual property to a customer in exchange for a usage-based royalty. At contract inception, the contract meets all the criteria under AASB 15.9 and revenue is recognised based on usage.

During the second year of the contract, the customer continues to use the entity’s licence, but the customer’s financial condition declines and their ability to pay significantly deteriorates.

Analysis and accounting treatment:

The entity recognises royalty earned in the first year as revenue, as the contract meets the recognition criteria under AASB 15. In the second year, the entity determines it is no longer probable to collect the entitled consideration. Therefore, the entity does not recognise any further revenue associated with the customer’s future usage of its patent. The entity accounts for any impairment of the existing receivable under AASB 9 Financial Instruments.

3.1.5 Combined contracts

An entity should combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract, if one or more of the following criteria are met (AASB 15.17):

- the contracts are negotiated as a package with a single commercial objective
- the consideration to be paid in one contract depends on the price or performance of the other contract; or
- the goods or services promised are a single performance obligation (see Section 3.2.2)

3.1.6 Additional Step 1 considerations for NFP entities

Customer of a NFP entity

The customer of a NFP entity is sometimes not clearly identifiable. The customer is the party that promises consideration in exchange for goods or services that are an output of the entity’s ordinary activities. The customer might direct goods or services to be provided to third-party beneficiaries (including individuals or the community at large). In these contracts:

- the customer remains the party that has contracted with the entity and promises consideration in exchange for those goods or services
- the provision of goods or services to third-party beneficiaries is a characteristic of the promised transfer of goods or services to the customer (AASB 2016-8.F6).

Example:

A NFP entity receives consideration from an individual X for the specified purpose of providing first-aid training to members of the community.

In this instance, the individual X is the customer because he/she has contracted with the entity to provide the first-aid training services. This conclusion is not affected by the fact that individual X specifies those services are to be provided to members of the community.
Enforceable agreement for a NFP entity

An inherent feature of a contract with a customer is that the entity makes promises in an agreement that creates enforceable rights and obligations. NFP agencies should note the following key considerations on enforceability:

▪ An agreement, whether in writing or oral, is enforceable when a separate party is able to enforce it through legal or ‘equivalent means’ (AASB 2016-8.F11). For an agreement to be enforceable through ‘equivalent means’, it requires the presence of a mechanism outside the legal system that establishes the right of a customer to oblige the entity to act in a particular way or be subject to consequence. For example, a ministerial authority to require a transfer of goods or services.

▪ Enforceability needs to be considered in relation to particular terms of an agreement and any additionally agreed terms as a result of further discussions or actions. Examples of terms in agreements that result in enforceability (AASB 2016-8.F12):
  o a refund in cash or kind when the agreed specific performance has not occurred;
  o the customer, or another party acting on its behalf, has a right to enforce specific performance or claim damages;
  o the customer has the right to a financial interest in assets purchased or constructed by the entity;
  o the parties to the agreement are required to agree on alternative uses of the resources provided under the agreement; and
  o an administrative process exists to enforce agreements between sovereign States or between a State and another party

▪ The enforceability of agreements does not depend on their form. For example, documents such as Memoranda of Understanding, Heads of Agreement and Letters of Intent can constitute legally enforceable agreements (AASB 2016-8.F13).

▪ Agreements that explicitly state they are not intended to be legally binding may nonetheless become enforceable agreements if the parties act in a manner that is inconsistent with the stated intention (AASB 2016-8.F13).

▪ Agreements that lack elements of a contract may nonetheless become legally enforceable if there is conduct by one party that causes the other party to act in reliance on such conduct (AASB 2016-8.F13).

  Enforcement mechanisms may arise from administrative arrangements or statutory provisions e.g. a directive given by a Minister or government department to a public sector entity (AASB 2016-8.F14).

▪ A capacity to impose a severe penalty for non-performance can exist without a capacity to require a return of transferred assets or assets of equivalent value. The authority to require compensation may be the key determinant of the enforceability of an agreement involving a promise to transfer goods or services (AASB 2016-8.F15).

▪ A contract could still be enforceable despite a lack of history of enforcement and despite the customer’s intention not to enforce. The customer’s intent not to enforce is at its discretion and does not affect their right to enforce. Enforceability depends on the customer’s capacity to enforce (AASB 2016-8.F16).
A Statement of Intent is generally a public policy statement and does not identify the parties who could enforce the statement. Such a statement of intent, of itself, would be insufficient to create an enforceable agreement. This is in contrast to a Letter of Intent which is typically an agreement between specifically identified parties (AASB 2016-8.F17).

A transferor’s capacity to withhold future funding to which the entity is not presently entitled, would not, by itself, create an enforceable agreement (AASB 2016-8.F17).

**Commercial substance**

A contract may have commercial substance even if it is non-commercial to the NFP entity (for example, subsidised goods or services). ‘Commercial substance’ should be read as a reference to economic substance i.e. giving rise to substantive rights and obligations (AASB 2016-8.F19).

### 3.2 Step 2 - Identify the performance obligations in the contract

This step requires an entity to determine whether the contract with a customer contains performance obligations. These are promises to transfer distinct goods or services (AASB 15.22). AASB 15 provides guidance on the meaning of ‘distinct’.

#### Table 2 - Summary of key considerations for Step 2

<table>
<thead>
<tr>
<th>Section</th>
<th>Topic</th>
<th>Description of Section Contents</th>
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<tbody>
<tr>
<td>3.2.1</td>
<td>Promises in a contract</td>
<td>Promises can be explicit or implied. Administrative tasks to set up a contract are not performance obligations.</td>
</tr>
<tr>
<td>3.2.2</td>
<td>Determining when promises are performance obligations</td>
<td>Promises represent performance obligations if:</td>
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<td></td>
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<td>- goods or services are distinct; or</td>
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<td></td>
<td>- goods and services are part of a series of similar distinct goods</td>
</tr>
<tr>
<td>3.2.3</td>
<td>Determining whether goods or services are distinct</td>
<td>A good or service is distinct if:</td>
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<td>- the customer can benefit from the good or service on its own, or together with other readily available resources; and</td>
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<td></td>
<td>- the promise to transfer the good or service is separately identifiable in the contract</td>
</tr>
<tr>
<td>3.2.4</td>
<td>Series of distinct goods or services</td>
<td>A series of distinct goods or services is considered a single performance obligation if certain criteria are met. Then, an entity applies revenue recognition principles to a single performance obligation.</td>
</tr>
<tr>
<td>3.2.5</td>
<td>NFP considerations</td>
<td>The promise of the NFP entity should be sufficiently specific. This involves judgement, taking into account explicit or implicit conditions regarding the promised goods or services.</td>
</tr>
</tbody>
</table>
3.2.1 Promises in a contract

Promises to transfer goods or services can be explicitly stated in the contract or be implied by an entity's customary business practices, published policies or specific statements that create a valid expectation that the entity will transfer goods or services to the customer (AASB 15.24).

Administrative tasks to set up a contract are not performance obligations as they do not transfer goods or services to the customer (AASB 15.25).

Examples of promised goods or services (AASB 15.26):

- sale of goods produced by an entity (e.g. inventory of a manufacturer)
- resale of goods purchased by an entity (e.g. merchandise of a retailer)
- resale of rights to goods or services purchased by an entity (e.g. tickets resold by an entity acting as a principal)
- performing contractually agreed-upon tasks for a customer
- goods or services available for a customer to use as and when the customer decides
- arranging for another party to transfer goods or services to a customer i.e. acting as an agent of another party
- granting rights to goods or services to be provided in the future that a customer can resell or provide to its customer (e.g. an entity selling a product to a retailer promises to transfer an additional good or service to an individual purchasing the product from the retailer)
- constructing, manufacturing or developing an asset on behalf of a customer;
- granting licences
- granting options to purchase additional goods or services (when those options provide a customer with a material right).

3.2.2 Determining when promises are performance obligations

After identifying the promised goods and services in a contract, an entity determines which of those promises will be treated as performance obligations.

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either (AASB 15.22):

(a) a good or service (or a bundle of goods or services) that is distinct; or
(b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer

Therefore promises to transfer goods or services are performance obligations if the goods or services are:

- distinct (including as part of a bundle); or
- part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer

If a promised good or service is not distinct, an entity should combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, this would result in accounting for all the goods or services promised in a contract as a single performance obligation (AASB 15.30).

The definition of ‘distinct’ is discussed further in the next section.
3.2.3 Determining whether goods or services are ‘distinct’

AASB 2016-3.27 has two criteria for determining whether a promised good or service is distinct:

- the customer must be able to benefit from the good or service on its own, or together with other readily available resources
- the promise to transfer the good or service is separately identifiable in the contract.

**The customer can benefit**

A good or service is capable of being distinct if the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (AASB 2016-3.27).

This is so, if the good or service could be used, consumed, sold for an amount that is greater than scrap value or otherwise held in a way that generates economic benefits (AASB 15.28).

Various factors may provide evidence of a distinct good or service. For example, an entity regularly selling a good or service separately, indicates that a customer can benefit from the good or service on its own or with other readily available resources (AASB 15.28).

**Promise to transfer the good or service is separately identifiable in the contract**

A promise to transfer the good or service is distinct within the context of the contract if the entity’s promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (AASB 2016-3.27). Factors indicating that the promises to transfer goods or services are not separately identifiable include (AASB 2016-3.29):

- the entity provides a significant service of integrating the goods or services with other goods or services into a bundle of goods or services that represent the combined output

  **Example** - A customer requires the construction of a wall in a dwelling. The contract contains provision of raw materials (bricks and mortar) and a building service. Whilst building services could be provided by another builder, the promises are not separately identifiable in the contract (the customer requires a ‘finished’ wall not the bricks and mortar) and therefore this is a single performance obligation.

- one or more of the goods or services significantly modifies or customises, or are significantly modified or customised by, one or more of the other goods or services promised in the contract

  **Example** - An entity promises to provide a customer with software that it will significantly customise to make the software function with the customer’s existing infrastructure. The entity determines it is providing a fully integrated system and the customisation service requires it to significantly modify the software in such a way that the risks of providing the software together with the customisation service are inseparable.

- the goods or services are highly interdependent or highly interrelated

  **Example** - A company sells specialised equipment and installation services. The installation is complex and cannot be provided by alternative service providers. The equipment will not be operational if not installed by the same company.
3.2.4 Series of distinct goods or services

In certain contracts, multiple distinct goods or services will comprise a single performance obligation. These distinct goods and services may be identical to each other, or not. However, this assessment requires going to Step 5 (see Section 3.5.2) to assess whether the performance obligation is satisfied over time.

A series of distinct goods or services provided over time (e.g. delivering utilities, cleaning services etc.) are considered a single performance obligation if they are substantially the same and have the same pattern of transfer to the customer (AASB 15.22). A series of distinct goods or services has the same pattern of transfer if (AASB 15.23):

- each distinct good or service in the series would meet the criteria to be a performance obligation that would be satisfied over time (see Section 3.5.2); and
- the same method will be used to measure progress towards satisfying the obligation to transfer each distinct good or service in the series to the customer (see Section 3.5.2)

An entity should apply the revenue recognition principles to a single performance obligation when the series criteria are met, rather than the individual goods or services that make up the single performance obligation (AASB 15.22).

In the example below, the single performance obligation is to provide property management services. Such services could include individual goods or service components. Because the ‘series’ criteria is met, the revenue recognition principles are applied to property management services as a whole, instead of individual goods or services that make up the single performance obligation.

Example – Series of distinct services treated as a single performance obligation

Entity B contracts to provide property management services for a 5-year period. The compensation is a percentage of the property rental and reimbursement for the labour costs of the services.

Analysis

This contract contains multiple distinct services, each being periodic property management services. Each distinct service is the substantially the same and is provided as a series.

Entity B next assesses whether the series of distinct services have the same pattern of transfer to the customer.

The property management services are simultaneously received and consumed by the customer - therefore each distinct service would meet the criteria to be a performance obligation that would be satisfied over time.

Finally, Entity B implicitly uses labour costs incurred to measure progress for all services in the series.

In conclusion, the arrangement is a series of distinct services that should be treated as a single performance obligation that is performed over time.
3.2.5 Additional Step 2 considerations for NFP entities

**Sufficiently specific performance obligations**

Some transfers of assets to NFP entities are provided with no, or minimal, terms and conditions regarding how the transferred assets must be used, other than that the assets are used for purposes consistent with the entity’s service-delivery objectives. For example, a NFP entity may have the discretion to change the goods or services to be provided using the donated assets, even when the donations are received for specific purposes, to enable the NFP entity to redirect the assets to a different purpose with a greater priority.

Some other transfers to NFP entities are provided solely on the condition that the funds are to be expended within a specified time period.

The circumstances described above are much more prevalent in the NFP sector than the for-profit sector. Hence the standard setters decided to prescribe a ‘sufficiently specific’ criterion for performance obligations to be in scope of AASB 15.

To be in scope of AASB 15, a NFP entity’s enforceable promise to transfer goods or services must be sufficiently specific to allow the entity to determine when the performance obligation is satisfied, as this indicates the transfer of goods or services is not at its discretion (AASB 2016-8.BC39). The following are some key considerations in determining a ‘sufficiently specific’ performance obligation:

- Judgement is necessary to assess whether a promise is sufficiently specific. This takes into account any explicit or implicit conditions regarding the promised goods or services, including conditions on (AASB 2016-8.F20):
  - the nature or type of the goods or services
  - the cost or value of the goods or services
  - the quantity of the goods or services
  - the period over which the goods or services must be transferred.

- A service can include an arrangement whereby one entity undertakes specific activities on behalf of another entity. Activities may include service delivery, research or asset management, among others. However, performance obligations do not include activities undertaken to fulfil a contract unless those activities transfer a good or service to a customer. For example, research activities undertaken to develop intellectual property that the entity will license to a customer are not themselves a transfer of goods or services to the customer (AASB 2016-8.F21).

- A statement of intent, charter or stated objectives alone would generally not enough to create a performance obligation (AASB 2016-8.F23 and F25).

- A condition that a NFP entity should transfer unspecified goods or services within a particular period does not, by itself, meet the ‘sufficiently specific’ criterion. For example, where a NFP entity receives an endowment to be used for an unspecified purpose over a particular time period, such a promise is not sufficiently specific (AASB 2016-8.F24).

- If the transfer does not specify the period over which the entity must use the funds or the services to be provided (such as the number of counselling sessions), the entity would not meet the ‘sufficiently specific’ criterion because it would be unable to determine when it meets the performance obligations (AASB 2016-8.F25).

- Although not a necessary precondition, an acquittal process to demonstrate progress towards transferring goods or services may provide evidence of a sufficiently specific promise. For example, an agreement may require the entity to report on progress toward specified outputs or outcomes in an acquittal process (AASB 2016-8.F26).
Where a contract transfers a financial asset for an entity to acquire or construct a non-financial asset (e.g. a building or an intangible asset) that is to be controlled by the entity, the contract does not establish rights and obligations for the transfer of the non-financial asset to the transferor or other parties (AASB 2016-8.F27). Accordingly, the contract is not a contract with a customer under AASB 15. Instead it is accounted for under AASB 1058 Income of Not-for-Profit Entities (AASB 1058).

3.3 Step 3 - Determine the transaction price

“...The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties...” (AASB 15.47 and Appendix A)

The transaction price is the amount of consideration the seller expects to be entitled to in exchange for transferring promised goods or services to the customer. This excludes sales taxes and other amounts collected on behalf of third parties. The consideration promised may include fixed and/or variable amounts.

An entity should consider the terms of the contract and its customary business practices to determine the transaction price (AASB 15.47).

An entity also assumes that the goods or services will be transferred to the customer as promised under the existing contract and that the contract will not be cancelled, renewed or modified (AASB 15.49).

Table 3 - Summary of key considerations for Step 3

<table>
<thead>
<tr>
<th>Section</th>
<th>Topic</th>
<th>Description of Section Contents</th>
</tr>
</thead>
</table>
| 3.3.1   | Variable consideration and constraining estimates of variable consideration | An entity should estimate an amount of variable consideration based on either of:
|         |                                 | - the expected value; or
|         |                                 | - the most likely amount
|         |                                 | The estimate of variable consideration can only be recognised to the extent it is highly probable that a significant revenue reversal will not occur in future. |
| 3.3.2   | Significant financing component  | Contracts may contain a financing component, even where this is not explicitly stated. AASB 15 requires significant financing components to be accounted for separately. This section explains how to assess whether there is a significant financing component and the accounting treatment. |
| 3.3.3   | Non-cash consideration           | If the customer provides non-cash consideration, this should be measured at fair value. If the fair value cannot be reasonably estimated, measure the non-cash consideration indirectly by reference to the stand-alone selling price of the promised goods or services. |
| 3.3.4   | Consideration payable to a customer | Where a contract provides for the customer to pay consideration to the seller, this can be accounted for as either a:
|         |                                 | - Purchase by the seller; or
|         |                                 | - Change to the original transaction. |
The accounting treatment depends on whether:
- the payment is for distinct goods or services
- the entity can reasonably estimate the fair value of the goods or services received
- the consideration payable exceeds the fair value of goods or services

In determining the transaction price, an entity should consider the effects of the components in the diagram below.

**Determining transaction price**

### 3.3.1 Variable consideration and constraining estimates of variable consideration

An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if the consideration is contingent on the occurrence or non-occurrence of a future event. For example, a product was sold with a right of return or a performance bonus is promised on achievement of a specified milestone (AASB 15.51).

An entity should estimate an amount of variable consideration based on either of (AASB 15.53):

- *The expected value* - sum of probability-weighted amounts in a range of possible consideration amounts. This is appropriate when an entity has a large number of contracts with similar characteristics.

- *The most likely amount* - the single most likely amount in a range of possible consideration amounts (i.e. the single most likely outcome of the contract). This is appropriate when the contract has only two possible outcomes (e.g. an entity either achieves a performance bonus or not).

An entity should recognise a refund liability if it expects to refund some or all of the consideration received or receivable (AASB 15.55).
**Example - Estimating variable consideration based on the expected value**

Entity A enters into a contract with a customer to build an asset for $200,000 with a performance bonus of $50,000 based on the timing of completion. The amount of the performance bonus decreases by 10% per week for every week beyond the agreed-upon completion date. The contract requirements are similar to contracts Entity A has performed previously, and it concludes that the *expected value method* is most predictive in this case.

Entity A estimates there is a 60% probability of completion by the agreed date, a 30% probability that it will be delayed by a week, and a 10% probability that it will be delayed by two weeks.

How should Entity A determine the transaction price?

**Analysis**

The transaction price is the estimate of the consideration entitled for the work performed.

**Probability-weighted consideration under the expected value method:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Probability</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>(fixed fee plus full performance bonus) x 60%</td>
<td>60%</td>
<td>$150,000</td>
</tr>
<tr>
<td>(fixed fee plus 90% of performance bonus) x 30%</td>
<td>30%</td>
<td>$73,500</td>
</tr>
<tr>
<td>(fixed fee plus 80% of performance bonus) x 10%</td>
<td>10%</td>
<td>$24,000</td>
</tr>
<tr>
<td>Total probability-weighted consideration</td>
<td></td>
<td>$247,500</td>
</tr>
</tbody>
</table>

The total transaction price of $247,500 is based on the probability-weighted estimate. Entity A should update its estimate at each reporting date. This example does not consider the potential need to constrain the estimate of variable consideration (see below).

An entity should apply one of the above methods consistently throughout the contract when estimating the effect of an uncertainty on the amount of variable consideration entitled (AASB 15.54). However, if the contract has more than one uncertainty (e.g. price index, completion targets etc.) the entity may determine the appropriate method for different uncertainties (IFRS 15.BC202).

**Constraint on variable consideration estimates**

AASB 15 imposes a constraint on the estimate of variable consideration. The estimate of variable consideration can only be recognised to the extent it is highly probable that a significant revenue reversal will not occur in future periods (AASB 15.56).

In making such assessment, an entity should consider the likelihood and the magnitude of the revenue reversal. Examples of factors that could increase the likelihood or the magnitude of a revenue reversal include (AASB 15.57):

- the amount of consideration is highly susceptible to factors outside the entity’s influence (e.g. volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service)
- the uncertainty about the amount of consideration is not expected to be resolved for a long period of time
- the entity’s experience (or other evidence) with similar types of contracts is limited, or has limited predictive value
- the entity has a practice of either offering a broad range of price concessions or changing the payment terms of similar contracts in similar circumstances
- the contract has a large number and broad range of possible consideration amounts.

It is important to understand that estimating variable consideration and applying constraints may not be a two-step process. An entity would not be required to strictly follow those two steps if the process for estimating variable consideration already incorporates the principles of constraining such estimates (IFRS 15.BC215).
For example, an entity estimates revenue from the sale of goods with a right of return. Such estimation incorporates the expectation of returns at a level at which it is highly probable there will be no significant revenue reversal. In this instance, the variable consideration estimates faithfully reflect the entitled consideration. Consequently, there is no need to apply the constraint requirements separately.

**Example – Revenue reversal constraint**

Entity A contracts to sell 1,000 units to a retailer at $100 each, plus a variable consideration of $25 each. Entity A’s products have a high risk of obsolescence and the variable consideration is receivable on the number of units sold in turn by the retailer within 6 months. Based on the average of five-year observable data, Entity A expects 200 units to remain unsold by the retailer in that timeframe. However in the previous year, 300 units were unsold within the 6-month timeframe and there is a reasonable chance of a similar outcome this year.

**Analysis**

The total maximum consideration at contract inception is $125,000, calculated as the fixed consideration of $100,000 (1,000 units X $100) plus the maximum variable consideration of $25,000 (1,000 units X $25).

The estimated variable consideration using the expected value method is $20,000 (1,000 – 200) X $25). This is based on the average of five-year observable data.

Entity A considers constraining the estimates of variable consideration to determine whether some or all of $20,000 can be included in the transaction price.

The variable consideration is susceptible to factors outside Entity A’s influence (i.e. risk of obsolescence). Though the five-year observable data places the unsold units at 200, the number is higher for the immediate preceding year and there is a reasonable chance of a similar outcome this year.

Consequently, Entity A concludes it is highly probable that significant revenue reversal will not occur only if it considers $17,500 ($25 X 700 units) as the variable consideration.

**Accounting**

Entity A will recognise a transaction price of $117,500 ($100,000 fixed consideration plus $17,500 constrained variable consideration) as revenue when 1,000 units are transferred to the retailer.

**Right of return**

In some contracts, an entity transfers control of a product to a customer and also grants a right to return for various reasons e.g. dissatisfaction with the product (AASB 15.B20). An entity will estimate the transaction price by excluding the consideration for the products expected to be returned.

Consequently, the entity will recognise a refund liability representing its obligation to return the customer’s consideration and an asset for its right to recover products from customers, with corresponding adjustment to cost of sales (AASB 15.B21).
Example – Right of return
Entity A contracts to sell 1,000 products @ $100 each for a total price of $100,000. The entity’s customary business practice is to allow a customer to return any unused product within 30 days and receive a full refund. The entity’s cost of each product is $60. Using the expected value method, Entity A estimates that 97 products will not be returned.
Entity A determines that although the returns are outside its influence, it has significant experience in estimating returns for this product and customer class.

Analysis
Because the contract allows a customer to return the products, the consideration received from the customer is variable. To estimate the variable consideration entitled, Entity A uses the expected value method (sum of probability-weighted amounts in a range of possible consideration).
Entity A’s past experience in estimating returns suggests a likelihood of a return of three products.
Consequently, upon transfer of control of the 100 products, Entity A does not recognise revenue for the three products that it expects to be returned. Entity A will also recognise an asset for its right to recover products from customers on settling the refund liability.

Accounting treatment
Revenue recognition:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Receivable</td>
<td>10,000 ($100 X 100 products)</td>
</tr>
<tr>
<td>Cr. Revenue</td>
<td>9,700 ($100 X 97 products)</td>
</tr>
<tr>
<td>Cr. Refund liability</td>
<td>300 ($100 X 3 products)</td>
</tr>
</tbody>
</table>

Recognising the right to recover:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Asset - Right to recover</td>
<td>180 (cost price $60 X 3 products)</td>
</tr>
<tr>
<td>Cr. Cost of sale</td>
<td>180</td>
</tr>
</tbody>
</table>
3.3.2 Significant financing component

Some contracts contain a financing component when payment by a customer occurs either significantly before or after the performance obligations. This can, in effect, provide the customer or the seller with a significant financing benefit.

Where there is a significant financing component, AASB 15 requires:

- adjustment of the transaction price by discounting the promised consideration to account for the time value of money (AASB 15.60)
- separately accounting for the finance component, including interest (AASB 15.65).

In separating out a financing component, the objective is to recognise revenue that reflects the cash selling price as if the customer had paid the consideration at the same time the goods or services are transferred (AASB 15.61).

All relevant facts and circumstances should be considered in assessing whether a contract contains a significant financing component, including (AASB 15.61):

- the difference, if any, between the promised consideration and cash selling price of the promised goods or services
- the combined effect of the expected length of time to receive payment and prevailing relevant market interest rates.

A contract does not have a significant financing component if (AASB 15.62):

- payment is received in advance and the timing of the transfer of those goods or services is at the discretion of the customer (e.g. customer loyalty points);
- a substantial amount of the consideration is variable and the amount or timing varies on the basis of a future event not substantially within the control of the customer or the entity (e.g. sales-based royalty); or
- the difference between the promised consideration and the cash selling price of the good or service, arises from non-finance reasons (e.g. retention payments held back to protect against either party not completing its obligations under the contract)

When adjusting the transaction price, an entity should use a discount rate that would be used in a separate financing transaction between the entity and the customer at contract inception (AASB 15.64). This applies to payments received both in advance (i.e. interest revenue) and in arrears (i.e. interest expense).

The discount rate should reflect the credit characteristics of the party that receives financing, as well as any collateral or security provided by the customer or the entity, including assets transferred in the contract. Further, the discount rate should not be updated for changes in circumstances (e.g. interest rate changes, change in the customer's credit risk assessment etc.) (AASB 15.64).
Example – Significant financing component – customer pays in arrears

Entity B contracts to provide a machine with payments from the customer over 2 years in monthly instalments of $4,500 totalling $108,000. The cash selling price of the machine would be $100,000 where payment is on delivery.

Analysis

There is a difference of $8,000 between the cash selling price of $100,000 and the promised consideration (total of monthly instalments) of $108,000. Entity B assesses this is the combined effect of the expected length of time to receive the full consideration and prevailing relevant market interest rates. Therefore Entity B determines the contract includes a financing component, though the contract does not explicitly refer to an interest charge.

The implicit rate is computed as 7.5% based on the cumulative interest ($8,000) and the settlement period. Entity B determines that the financing component is significant as it represents 8% of the selling price. Therefore an adjustment is required to adjust the time value of money.

Entity B recognises:

- Revenue of $100,000 when the performance obligation is satisfied (i.e. when the machine is delivered); and
- Interest income on a monthly basis using the effective interest method. The interest income for each month is based on the outstanding balance receivable.

As a practical expedient, an entity need not adjust the transaction price if it expects to receive payment within 12 months of transferring the promised good or service (AASB 15.63).

3.3.3 Non-cash consideration

Non-cash consideration (e.g. property, plant and equipment or a financial instrument) should be measured at fair value (AASB 15.66). If an entity cannot reasonably estimate the fair value of non-cash consideration, it measures the non-cash consideration indirectly by reference to the stand-alone selling price of the promised goods or services (AASB 15.67). Non-cash consideration received from a customer to facilitate fulfilment of the contract (e.g. materials or equipment) is recognised as revenue when the seller obtains control of the contributed goods or services (AASB 15.69).
3.3.4 Consideration payable to a customer

Consideration payable to a customer includes (AASB 15.70):

- cash amounts that an entity pays, or expects to pay, to the customer or to other parties that purchase the entity’s goods or services from the customer (i.e. the customer’s customer)
- credit or other items (e.g., a coupon or voucher) that can be applied against amounts owed to the entity or to the customer’s customer

An entity should determine whether the consideration payable to a customer represents (AASB 15.70):

- payment for distinct goods or services by the seller – i.e. a purchase by the seller; and/or
- reduction of the transaction price.

Further, if the price paid for distinct goods or services exceeds their fair value, the excess reduces the transaction price of the original transaction.

Refer to the decision tree below for the appropriate accounting treatment (AASB 15.71-72):

Accounting for consideration payable to a customer (or to the customer’s customer)
### 3.4 Step 4 – Allocate the transaction price to each performance obligation

Once the performance obligations are identified and the transaction price determined, the transaction price is allocated to the performance obligations in proportion to their relative stand-alone selling prices (AASB 15.74).

#### Objective when allocating the transaction price

The objective when allocating the transaction price is for an entity to allocate the transaction price to each performance obligation (or distinct good or service) in an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer (AASB 15.73).

AASB 15 requires the use of the **relative stand-alone selling price basis** to allocate the total transaction price to the various service performance obligations in a sales contract. For many contracts, there will be a single service performance obligation, and this will be relatively simple. However where a contract contains multiple goods or services, Step 4 can be complex, and necessitate making estimates. Further complexities arise from discounts, variable consideration and any changes in the transaction price.

After initial allocation, changes to the transaction price are allocated to the performance obligations on the same basis as at contract inception. Consequently, the transaction price should not be reallocated to reflect changes in stand-alone selling prices after contract inception (AASB 15.88).

#### Table 4 - Summary of the key considerations for Step 4:

<table>
<thead>
<tr>
<th>Section</th>
<th>Topic</th>
<th>Description of Section Contents</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.4.1</td>
<td>Allocation based on stand-alone selling prices</td>
<td>This section describes the objective in allocating the transaction price to each performance obligation. This is done using the stand-alone selling price of each distinct good or service underlying each performance obligation. If stand-alone selling prices are not directly observable, there are rules on how to estimate these.</td>
</tr>
<tr>
<td>3.4.2</td>
<td>Allocation of a discount</td>
<td>Discounts are allocated proportionately to all performance obligations unless the discount does not relate to all performance obligations. A discount should be allocated to one or more, but not all, performance obligations if certain criteria are met.</td>
</tr>
<tr>
<td>3.4.3</td>
<td>Allocation of variable consideration</td>
<td>Variable consideration is allocated to either: - The entire contract; - One or more, but not all, service performance obligations in a contract; or - One or more, but not all, distinct goods or services that form part of a single performance obligation</td>
</tr>
<tr>
<td>3.4.4</td>
<td>NFP considerations</td>
<td>A customer may enter into a contract with a NFP entity with a dual purpose of obtaining goods or services and to help the NFP entity achieve its objectives. For these contracts, revenue recognition is based on a rebuttable presumption that the transaction price relates wholly to the transfer of promised goods or services.</td>
</tr>
</tbody>
</table>
3.4.1 Allocation based on stand-alone selling prices

The allocation of the total transaction price to performance obligations is done by (AASB 15.76):

1. Determining the stand-alone selling price of the distinct good or service underlying each performance obligation; and

2. Allocating the transaction price (Step 3) to each of the performance obligations (Step 2), in the same proportion as the stand-alone selling prices.

This is done at the inception of the contract.

**Example**

Entity A has a contract with customer B to sell computer equipment, provide training and operate an IT helpdesk. Each of these has been assessed to be separate performance obligations. The total transaction price has been determined to be $1,200,000.

Entity A determines that the stand-alone selling price for each distinct good or service is:

<table>
<thead>
<tr>
<th>Service</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer equipment</td>
<td>750,000</td>
</tr>
<tr>
<td>Training</td>
<td>150,000</td>
</tr>
<tr>
<td>Helpdesk</td>
<td>600,000</td>
</tr>
<tr>
<td><strong>Total of standalone prices</strong></td>
<td><strong>1,500,000</strong></td>
</tr>
</tbody>
</table>

The total transaction price is allocated to each service performance obligation as follows:

<table>
<thead>
<tr>
<th>Service</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Computer equipment</td>
<td>600,000</td>
</tr>
<tr>
<td>Training</td>
<td>120,000</td>
</tr>
<tr>
<td>Helpdesk</td>
<td>480,000</td>
</tr>
<tr>
<td><strong>Total transaction price</strong></td>
<td><strong>1,200,000</strong></td>
</tr>
</tbody>
</table>

**What is the stand-alone selling price?**

This is the price at which an entity would sell a distinct good or service separately on a stand-alone basis.

The best evidence of the stand-alone selling price is an observable price when the seller sells that same good or service in similar circumstances and to similar customers. A contractually stated price or a list price may be the stand-alone selling price (AASB 15.77).

In some instances, the stand-alone selling price is not directly observable and it is necessary to make an estimate. The estimation method should maximise the use of observable inputs and should be applied consistently (AASB 15.78).
AASB 15.79 suggests the following as potentially suitable estimation methods:

- **Adjusted market assessment approach** - evaluating the market in which the entity sells the goods or services and estimating the price that customers would be willing to pay. This could include referring to competitor prices, adjusted for the entity’s costs and margins.

- **Expected cost plus a margin approach** - forecasting expected costs plus an appropriate margin; or

- **Residual approach** - deducting the observable stand-alone selling prices of other goods or services in the contract from the total transaction price. This method is only allowed in certain circumstances where price is highly variable or not yet established.

A combination of the above methods may need to be used to estimate the stand-alone selling prices if some goods or services in a contract have highly variable or uncertain stand-alone selling prices (AASB 15.80).

3.4.2 **Allocation of a discount**

A discount arises where the sum of stand-alone selling prices exceeds the promised consideration in the contract.

In general, the total discount is allocated proportionately to all of the performance obligations in the contract.

The exception to this general rule is where there is observable evidence that the discount relates only to specific individual or bundles of performance obligations (AASB 15.81).

The criteria for allocating a discount to specific performance obligations are (AASB 15.82):

- the entity regularly sells each distinct good or service (or a bundle of) in the contract, on a stand-alone basis;

- the entity regularly sells on a stand-alone basis, a bundle(s) of some of the distinct goods or services at a discount compared to the stand-alone selling prices; and

- the discount attributable to each bundle of goods or services described above is substantially the same as the discount in the contract and an analysis provides observable evidence of the performance obligation(s) to which that discount relates.

**Example – Purchase price and discount allocation**

Entity A contracts with a customer to sell a machine for $100,000. The total contract price includes installation and a two-year warranty. Entity A determined the following three performance obligations and their stand-alone selling prices: machine — $75,000, installation services — $14,000 and warranty — $20,000. There is no observable evidence the discount relates specifically to one or more of the performance obligations.

**Analysis**

The aggregate stand-alone selling price of $109,000 ($75,000+$14,000+$20,000) exceeds the total transaction price of $100,000, meaning there is a discount in the contract. The discount should be allocated proportionately to all performance obligations based on their relative stand-alone selling prices. Therefore, the transaction price of $100,000 is allocated to each performance obligation as follows:

<table>
<thead>
<tr>
<th>Performance Obligation</th>
<th>Amount Allocated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machine</td>
<td>$68,807</td>
</tr>
<tr>
<td>Installation</td>
<td>$12,844</td>
</tr>
<tr>
<td>Warranty</td>
<td>$18,349</td>
</tr>
</tbody>
</table>

The entity recognises the amount allocated to each performance obligation as revenue when (or as) each performance obligation is satisfied.
3.4.3 Allocation of variable consideration

Variable consideration may be attributable to (AASB 15.84):

- all performance obligations in the contract – i.e. the entire contract;
- one or more, but not all, performance obligations in the contract (e.g. a bonus which is contingent on transferring a good or service within a specified time); or
- one or more, but not all, distinct goods or services in a series of distinct goods or services forming part of a single performance obligation (e.g. a cleaning and maintenance contract where consideration for the maintenance is based on an inflation index)

AASB 15 requires variable consideration to be allocated to specific performance obligations, or to distinct goods or services, if both the following apply (AASB 15.85):

(a) the terms of payment relate specifically to efforts to satisfy, or a specific outcome from satisfying, the performance obligation or transfer of the distinct goods or services; and

(b) the allocation meets the overriding allocation objective in AASB 15 (see above)

To the extent consideration is not allocated to specific performance objectives or transfers of distinct goods or services, it is allocated based on proportionate stand-alone selling prices (AASB 15.86).

3.4.4 Additional Step 4 considerations for NFP entities

*Dual purpose transactions: providing goods/service and receiving a donation*

A customer may enter into a contract with a NFP entity with a dual purpose of obtaining goods or services and to help the NFP entity achieve its objectives.

For these contracts, there is a rebuttable presumption that the transaction price relates wholly to the transfer of promised goods or services. The presumption is rebutted where the transaction price is partially refundable in the event the NFP entity does not deliver the promised goods or services (AASB 2016-8.F28 and F29 of Appendix F). This is because a partially refundable transaction price indicates some part of the transaction is a donation.

Where the presumption is not rebutted, the entity should recognise the full transaction price as revenue under AASB 15.

Where the presumption is rebutted, the entity should disaggregate the transaction price and account for (AASB 2016-8.F30 of Appendix F):

- the component that relates to the transfer of promised goods or services in accordance with AASB 15; and
- the remainder of the transaction price as a donation component in accordance with AASB 1058

To assist the above disaggregation, the following may be indicative of the donation component (AASB 2016-8.F31 of Appendix F):

- a non-refundable component of the transaction price; and
- where the entity has the status of a deductible gift recipient – the donor (i.e. the customer) can claim part of the transaction price as a tax deduction for a donation

**Example:**

A NFP entity sells on-line subscriptions that provide access to particular heritage sites for a year (a promised service to each customer) and also invites subscribers to donate a non-refundable nominated amount to generally assist the entity in pursuing its broad objectives.

The voluntary donation is separately identifiable from the price of the annual subscription. The annual subscription fee and the donation are both refundable if access were not provided for the entire subscription period.
Analysis

The presumption that the transaction price relates wholly to the transfer of promised goods or services is not rebutted as the transaction price is refundable in full. Hence the donation should not be accounted for separately. Instead the entire transaction price is allocated to the performance obligation of providing membership access. Consequently, the donation should be recognised as revenue when (or as) performance obligations under the arrangement are satisfied in accordance with AASB 15.

3.5  Step 5 - Recognise revenue when (or as) performance obligations are satisfied

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset (AASB 15.31).

For each performance obligation, an entity should determine, at contract inception, whether it satisfies the performance obligation (AASB 15.32):
- over time
  OR
- at a point in time

Satisfying a performance obligation is based on the principle of control under AASB 15.
3.5.1 Control-based revenue recognition approach

AASB 15 takes a controls-based approach to revenue recognition, where the transfer of a good or service happens as the customer obtains control of that good or service. This can happen either over time or at a point in time (AASB 15.32). This contrasts with AASB 118, where revenue is recognised when an entity transfers significant risks and rewards of ownership to the customer.

The standard setters determined it can be difficult judge when and whether an appropriate level of the risks and rewards of ownership of a good or service has been transferred to the customer. Applying a control-based approach aims to address this (IFRS 15.BC118).

What is control?

Control of an asset is the ability to direct the use of, and obtain substantially all remaining benefits from, the asset (i.e. the good or service). Control includes the ability to prevent others from directing the use of, and obtaining the benefits from, the asset (AASB 15.33).

The key limbs of control are (IFRS 15.BC120):

- **ability** - for an entity to recognise revenue, a customer must have the present right to direct the use of, and obtain substantially all remaining benefits from, the asset.
- **direct the use of** - a customer’s ability/right to deploy the asset in its activities, to allow another entity to deploy that asset, or to restrict another entity from deploying that asset.
- **obtain the benefits from** - the customer should have the ability to obtain substantially all of the remaining benefits (i.e. potential cash flows) from the asset. A customer can obtain the benefits directly or indirectly in many ways, such as by using, consuming, disposing, selling, exchanging, pledging or holding the asset.

---

Table 5 - Summary of key Step 5 considerations:

<table>
<thead>
<tr>
<th>Section</th>
<th>Topic</th>
<th>Description of Section Contents</th>
</tr>
</thead>
</table>
| 3.5.1   | Control-based revenue recognition approach | AASB 15 is based on the principle that the goods or services transfer when a customer obtains control. This can happen either over time or at a point in time. Key features of control of a good or service:  
- ability to direct the use; and  
- obtain substantially all remaining benefits |
| 3.5.2   | Performance obligations satisfied over time | Control is transferred, and therefore revenue is recognised, over time if certain criteria are met. Revenue is recognised over time, using a method that depicts its performance (i.e. an output or an input method) |
| 3.5.3   | Performance obligations satisfied at a point in time | If a performance obligation is not satisfied over time, control is transferred and revenue is recognised at a point in time. There are some indicators of transfer of control. |
3.5.2 Performance obligations satisfied over time

As indicated above, the first part of Step 5 is to determine whether control is transferred, and therefore revenue is recognised, over time. This is the case if any of the following criteria are met. Otherwise the performance obligation is taken to occur at a single point in time (AASB 15.35):

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The customer simultaneously receives and consumes the benefits, as the entity performs its obligations. The customer effectively gains control of the goods or services as the entity performs its obligations. <strong>Note:</strong> This criteria is met if, hypothetically, another entity would not need to substantially re-perform the work completed to date (AASB 15.B4).</td>
<td>Recurring services such as cleaning or payroll processing.</td>
</tr>
<tr>
<td>b) The entity’s performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced. <strong>Note:</strong> This applies in situations where the customer controls the work in progress (tangible or intangible) as the entity produces the goods or provides services (AASB 15.B5).</td>
<td>Construction on a customer’s site.</td>
</tr>
<tr>
<td>c) The entity’s performance does not create an asset with an alternative use to the entity and it has an enforceable right to payment for performance completed to date. <strong>Note:</strong> An asset has an alternative use if an entity can redirect the asset for another use or to another customer (AASB 15.B6).</td>
<td>Building a specialised asset that can be used only by that customer.</td>
</tr>
</tbody>
</table>

**Measuring progress over time**

If one of the above criteria is met, revenue is recognised over time, using a method that depicts its performance i.e. progress towards satisfaction of a performance obligation. The measurement method may be either an (AASB 15.41):

- output method (e.g. units produced); or
- input method (e.g. costs incurred or labour hours)

The diagram below explains the characteristics of the two methods (AASB 15.B15-B19).
An entity should apply a single method of measuring progress for each performance obligation satisfied over time and that method should be applied consistently to similar performance obligations and in similar circumstances. At the end of each reporting period, an entity should remeasure its progress towards complete satisfaction of a performance obligation (AASB 15.40).

In determining the appropriate method, an entity should consider the nature of the underlying good or service (AASB 15.41). As circumstances change over time, an entity should update its measure of progress to reflect any changes in the outcome of the performance obligation (AASB 15.43).

In some circumstances (e.g. in the early stages of a contract), an entity may not be able to reasonably measure the outcome of a performance obligation, but it expects to recover the costs incurred in satisfying the obligation. In those circumstances, the entity should recognise revenue only to the extent of the costs incurred, until such time that it can reasonably measure the outcome of the performance obligation (AASB 15.45).

Example – Measuring progress by an output method
Entity A contracts with a customer to replace a stretch of railroad track for a fixed fee of $100,000. All work in progress is the property of the customer. At the end of the reporting period, Entity A replaced 75 units of track out of 100 total units of track to be replaced.

The effort required of Entity A is consistent across each of the 100 units of track to be replaced. Entity A determines that the performance obligation is satisfied over time as the customer controls the work in process asset being created.

Analysis
Preferred method of measuring Entity A’s progress - An output method using the units of track replaced.

This method appropriately represents the services performed as the effort is consistent across each unit of track replaced.

Hence all work in progress for which control has transferred to the customer would be captured by this measure of progress.

The progress toward completion is 75% (75 units/100 units), so Entity A recognises revenue equal to 75% of the total contract price of $100,000, which is $75,000.

Example – Measuring progress by an input method
Entity B contracts to build a non-financial asset for a fixed price of $4 million. The contract contains a single performance obligation that is satisfied over time. Total estimated contract costs are $3.75 million. Costs incurred in year one are $750,000.

Entity B concludes that the performance obligation is satisfied over time as the customer controls the non-financial asset as it is created.

Analysis
In the early stages of the contract, Entity B may not be able to reasonably measure the outcome of a performance obligation. Hence, an input method using costs incurred (relative to the total expected cost) is an appropriate measure of progress toward satisfying the performance obligation.

Entity B recognises revenue based on a calculation of costs incurred relative to the total expected costs, based on the following calculation:

Progress towards completion – 20% ($750,000 / $3.75 million).

So revenue to be recognised is $800,000 (i.e. 20% of transaction price of $4 million).
3.5.3 Performance obligations satisfied at a point in time

If a performance obligation is not satisfied over time, control is transferred and revenue is recognised at a point in time.

Indicators of transfer of control include (AASB 15.38):

**Customer has legal title**

The transfer of legal title of a good or service may indicate that the customer has obtained control. However in some instances the seller retains legal title solely as protection against non-payment. In these circumstances, this would not preclude the customer obtaining control (AASB 15.38(b)).

**Transfer of physical possession**

There are some arrangements where the transfer of physical possession will not coincide with the transfer of control. These include some agreements that include repurchase options, consignment arrangements and bill and hold arrangements.
4. Other AASB 15 topics

AASB 15 provides implementation guidance to assist entities in applying revenue recognition principles to complex arrangements. This includes guidance on:

- contract modifications
- rights of return
- warranties
- principal versus agent considerations
- customer options for additional goods and services
- customers’ unexercised rights
- non-refundable upfront fees
- licensing
- repurchase rights
- consignment arrangements
- bill-and-hold arrangements

This section discusses some of the above topics. Agencies should review AASB 15 in detail, especially the implementation guidance section (Appendix B to AASB 15), to ensure they understand the revenue recognition requirements for the above arrangements.

4.1 Contract modifications

Contract modifications may be described as change orders, variations or amendments. AASB 15 contains specific requirements in respect of contract modifications.

*What is a contract modification?*

Contract modifications have the following features (AASB 15.18):

- are changes in the scope or price (or both)
- create new or change existing enforceable rights and obligations of the parties
- are approved by the parties

Approval can be in writing, by oral agreement or implied by customary business practices.

The existing contract is accounted for until the contract modification is approved.

*Enforceable rights and obligations*

Significant judgement will often be necessary in determining whether a proposed modification has been approved and has created new, or changed existing, enforceable rights and obligations of the parties (AASB 15.19). AASB 15 requires consideration of all relevant facts and circumstances, including contract terms, past experience and practice etc.

Judgement will also be needed where a change in the scope has been agreed, but not the price adjustment. In these circumstances the price change will need to be estimated in accordance with the guidance on estimating variable consideration (see Section 3.3.1).
Example – Enforceable rights
Entity A contracts with a customer to build a facility over a period of two years. Entity A identifies some environmental issues during site preparation that must be remediated before construction. Approval is obtained from the customer to perform the remediation work, but the price will be agreed in the future (i.e. it is an unpriced change order). Entity A completes the remediation and invoices $100,000 based on the costs incurred plus a profit margin. The customer challenges the charge as excessive.

Based on legal consultation and customary business practices, Entity A concludes that the performance of the remediation services gives rise to enforceable rights and that the amount charged is reasonable for the services performed.

Should Entity A account for the modification as approved?

Analysis
Despite the lack of agreement on the specific amount, the contract modification is approved and Entity A can account for the modification.

The next step is to determine the revised transaction price. Entity A estimates the corresponding change in transaction price in accordance with the guidance on variable consideration (see Section 3.3.1), after considering any revenue reversal.

How to account for a contract modification
AASB 15 contains THREE METHODS of accounting for contract modifications:

1. As a separate contract - where certain criteria are met.
   OR, where the criteria for a separate contract are not met, either:

2. As termination of the existing contract and creation of a new contract – if the remaining goods or services are distinct from those transferred before the modification date. This method accounts for the changes prospectively.
   OR

3. As if the modification is part of the existing contract – where the new goods or services are not distinct. This method uses the cumulative catch up basis.

Decision tree - accounting for contract modifications

If the remaining goods or services are a combination of distinct and non-distinct items, and the contract price increase is not commensurate with standalone selling prices, AASB 15 requires the modification to be accounted for in an appropriate manner that would achieve the objectives of AASB 15.21(a) and (b) to account for the remaining promised goods or services [AASB 15.21(c)].
**Contract modification accounted as a separate contract**

In determining how to account for a contract modification, the initial assessment is whether the contract modification should be treated as a separate contract. Both of the following conditions need to be present (AASB 15.20):

- the scope of the contract increases because of the addition of promised goods or services that are distinct (refer Section 3.2.2 and 3.2.3); AND
- the contract price increases by:
  - an amount that reflects the entity’s stand-alone selling prices of the additional promised goods or services; and
  - any appropriate price adjustments reflecting the contract circumstances

**Example – Contract modification accounted as a separate contract**

Entity A enters contracts with a customer to sell 50 goods for $5,000 ($100 per good). The goods are distinct and are transferred to the customer over a 12-month period. The parties modify the contract in the fifth month to sell an additional 10 goods for $95 each which is the stand-alone selling price on the modification date. The lower stand-alone price reflects the fact that Entity A no longer has to incur selling expenses to sell the additional 10 goods.

**Analysis and accounting treatment:**

The modification to sell an additional 10 goods at $95 each should be accounted for as a separate contract because the additional goods are distinct and the price reflects their stand-alone selling price. The existing contract would not be affected by the modification.

**Contract modification not accounted as a separate contract**

If the modification does not result in a separate contract based on the above criteria, there are two possible methods of accounting. This is based on whether the remaining goods or services are distinct from those in the original contract (AASB 15.21):

- If the remaining goods or services *are* distinct – The contract modification is accounted as if it were a termination of the existing contract and the creation of a new contract. The amount of consideration to be allocated to the remaining performance obligations is the sum of:
  - the consideration included in the estimate of the transaction price of the original contract that has not been recognised as revenue; and
  - the consideration promised as part of the contract modification
Example – Contract modification which is not a separate contract and the remaining goods or services are distinct

An entity enters into a contract to deliver 120 units of goods at $100 each over 10 months. The entity has delivered 60 units by the 3rd month. At the beginning of the 5th month, the entity agreed to deliver 30 more units at $95 each. It is determined that the additional 30 units are distinct goods. It is also determined that the consideration for the additional 30 units does not reflect their stand-alone prices.

Analysis and accounting treatment:
The contract is not a separate contract as the consideration paid for the additional units (i.e. modification) is not reflective of their stand-alone prices. The additional units are distinct and hence the contract modification is accounted as if it were a termination of the existing contract and creation of a new contract to deliver the remaining 90 units (60 undelivered units of the original contract and 30 additional units).

On the date of contract modification, no adjustment is required to previously recorded revenue.

The consideration included in the original contract that has not been recognised as revenue of $6,000 (60 X $100) is added to the contract modification amount of $2,850 (30 x $95). The total is recognised as revenue prospectively for the 90 units to be delivered.

The blended price is $98.33 per unit [($100 x 60 undelivered original units) + ($95 x 30 additional units) / 90 total units] will be recognised as revenue when or as the remaining 90 units are delivered.

- If the remaining goods or services are not distinct – The contract modification is accounted on a combined basis as if it were a part of the original contract. The modification is recognised as either an increase or decrease to the original contract revenue. In other words, the transaction prices from both the existing and modification contracts are combined, and then allocated to all the performance obligations.

The effect of the contract modification on the transaction price and progress towards performance obligation is recognised as an adjustment to revenue (i.e. the adjustment to revenue is made on a cumulative catch-up basis).
Example – Contract modification which is not a separate contract and the remaining goods or services are not distinct

Entity A contracts with a customer to build a machine for a consideration of $200,000. At contract inception, the entity expects the following:

- Transaction price $200,000
- Contract costs $150,000
- Profit (25% margin) $50,000

Entity A recognises revenue over time by measuring progress (towards construction) based on costs incurred. After the first year, the costs incurred were $60,000. Consequently, Entity A determined that it made a 40% progress towards completion based on costs incurred (i.e. $60,000/ $150,000) and recognised revenue of $80,000 (i.e. $200,000 X 40%). At the beginning of the second year, the parties agree to change the specification of the equipment and increase the consideration by $40,000. Entity A expects to incur additional cost of $36,000 towards the specification.

Analysis

The customer is not able to benefit from the modification on its own, nor is the promise separately identifiable. Therefore the remaining goods or services are not distinct. Hence the modification is not accounted for as a separate contract, and an assessment of the contract modification prices is not necessary. Because the goods or service are not distinct, the modification is accounted on a combined basis as if it were a part of the original contract and revenue is adjusted on a cumulative catch-up basis.

Accounting treatment

At the beginning of second year, Entity A updates its measure of progress and estimates that it has satisfied circa 32.26% of its performance obligation by revising its cost based measure of progress as follows:

- Total modified contract costs $186,000 ($150,000 + $36,000)
- Costs incurred after Year 1 $60,000
- Costs incurred as a % of total costs 32.26% (i.e. $60,000 / $186,000)

Consequently, Entity A reduces revenue by $2,576 based on the following:

- Total modified transaction price $240,000 ($200,000 + $40,000)
- Revenue based on revised progress completion $77,424 ($240,000 X 32.26%)
- Revenue initially recognised $80,000
- Revenue adjustment $2,576 ($80,000 - $77,424)
4.2 **Principal versus agent**

When more than one party is involved in providing goods or services to a customer, an entity should determine whether it is a principal or an agent by evaluating the nature of its promise to the customer (AASB 15.B34).

An entity determines whether it is a principal or an agent for each distinct good or service. If a contract includes more than one specified good or service, an entity could be a principal for some specified goods or services and an agent for others (AASB 2016-3.B34).

**Principal** (AASB 2016-3.B35) – characteristics and revenue recognition:

- An entity is a principal if it controls a specified good or service before transferring it to the customer.
- A principal entity in a contract may satisfy a performance obligation by itself or it may engage another party (e.g. a subcontractor).
- An entity does not necessarily control a distinct good if it obtains legal title to that good only momentarily before transferring to a customer.
- The principal entity should record as revenue the gross amount entitled in exchange for those goods or services transferred. Such revenue is recognised as and when the performance obligation is satisfied (AASB 2016-3.B35B).

**Agent** (AASB 2016-3.B36) – characteristics and revenue recognition:

- An entity is an agent if its role is to arrange for another entity to provide the specified goods or services.
- An agent does not control the specified good or service before transferring it to a customer.
- The agent entity should record as revenue the net amount that it retains for its agency services i.e. fee or commission. Such revenue is recognised as and when the performance obligation is satisfied.

Indicators that an entity controls the specified good or service before transferring to a customer and is therefore a principal include (AASB 2016-3.B37):

- The entity is primarily responsible for fulfilling the contract promise (e.g. meeting customer specifications).
- The entity has inventory risk before the goods have been transferred or after transfer of control (e.g. if the customer has a right of return).
- The entity has discretion in establishing price for the specified good or service. However an agent can have such discretion in some instances.
4.3 Licences of intellectual property

What is a license?
A licence establishes a customer’s rights to the intellectual property of an entity. Licences of intellectual property may include, but are not limited to, licences of any of the following (AASB 2016-3.B52):
- software and technology;
- motion pictures, music and other forms of media and entertainment;
- franchises; and
- patents, trademarks and copyrights

Distinct or non-distinct
AASB 15 first requires a determination whether the promise to grant a licence is distinct from other promised goods or services in the contract. This is done by applying Step 2 (see Section 3.2) to identify the performance obligations, and will often require the application of significant judgement.

- Accounting if license is not distinct
If the license is not distinct, then the grant of the license is combined with other performance obligation(s) in the contract, and recognised over time, or at a point in time, as appropriate (AASB 15.B55).

- Accounting if license is distinct
Specific application guidance is provided on assessing whether revenue from a distinct licence of intellectual property is recognised at a point in time or over time. To make this determination, an entity should consider whether the nature of the promise in granting the licence is to provide the customer with a right to (AASB 15.B56):
- **access** the entity’s intellectual property throughout the licence period; or
- **use** the entity’s intellectual property as it exists at the point in time the licence is granted

<table>
<thead>
<tr>
<th>What is provided by the licence</th>
<th>When revenue is recognised (AASB15.B60-61)</th>
</tr>
</thead>
<tbody>
<tr>
<td>A right to access the entity’s intellectual property throughout the licence period</td>
<td>Over time</td>
</tr>
<tr>
<td>A right to use the entity’s intellectual property as it exists at the point in time the licence is granted</td>
<td>Point in time</td>
</tr>
</tbody>
</table>

What is right to use?
If the customer can direct the use of, and obtain substantially all of the remaining benefits from, a licence at the point in time at which the licence is granted, then the entity has granted a right to use (AASB 15.B61).

What is right to access?
A licence provides a right to access the entity’s intellectual property if all the following exist (AASB 15.B58):
- the contract requires or the customer reasonably expects the entity will undertake activities that will significantly affect the intellectual property to which the customer has rights
- the rights granted by the licence directly expose the customer to any positive or negative effects of the entity’s activities
- those activities do not transfer a good or service to the customer, as they occur.
An entity’s activities significantly affect the intellectual property if (AASB 2016-3.B59A):
- those activities are expected to change the form (e.g. design or content) or functionality (e.g. the ability to perform a function or task) of the intellectual property;
- or
- the customer’s ability to obtain benefit from the intellectual property is substantially derived from, or dependent on, those activities, e.g. the entity’s ongoing activities that support or maintain the intellectual property value.

**Decision tree on accounting for intellectual property (IP) licences**

1. **Is the IP license distinct from other goods/services?**
   - Yes
   - No

2. **Does the customer have a right to access the entity’s IP?**
   - Yes
   - No

- **Recognise revenue on the IP at a point in time when the licence transfers to the customer**
- **Recognise revenue on the bundled product when or as performance obligations are satisfied**
- **Recognise revenue on the IP over time, throughout the licence period**

**4.4 Customer options for additional goods or services**

**Introduction**

Many sales contracts give customers the option to acquire additional goods or services. These additional goods and services may be priced at a discount or may even be free of charge (AASB 15.B39).

Options to acquire additional goods or services at a discount can come in many forms, including sales incentives, volume-tiered pricing structures, customer award credits (e.g. frequent flyer points) or contract renewal options (e.g. waiver of certain fees, reduced future rates).

**When to account for an option**

Options to acquire additional goods or services need to be accounted for separately where they create a separate performance obligation. This happens where the option provides a material right that the customer would not receive without entering into the contract (e.g. a discount that exceeds the range of discounts typically given for those goods or services). In such instances the customer has, in effect, paid in advance for future goods or services. If a customer has the option to acquire an additional good or service at a price that would reflect its stand-alone selling price that option does not provide the customer with a material right (AASB 15.B41). For example, if a customer receives an option to acquire additional goods at a discount typically provided for such goods, there is no material right. This is because the customer would receive the discounted price even without the existing contract.
How to account separately for an option

Accounting separately for an option impacts the amount and timing of revenue recognition, as follows:

1. The total transaction price is allocated to all performance obligations - including the option;
AND
2. Revenue in respect of the option is recognised when the future goods or service are transferred, or when the option expires (AASB 15.B40).

How to allocate the transaction price to the option

Consistent with Step 4 (see Section 3.4), the total transaction price is allocated based on stand-alone selling prices. If the stand-alone selling price of the customer option is not directly observable, the entity estimates this as (AASB 15.B42):

- the amount obtained by exercising the option;
- LESS
- the discount the customer would receive in a stand-alone transaction;
- MULTIPLIED BY
- the likelihood that the customer would exercise the option

Example – Option that provides the customer with a material right

An entity enters into a contract for the sale of Product A for $100. As part of the contract, the entity gives the customer a 40% discount voucher for any future purchases up to $100 (at the non-discounted price) in the next 30 days. The entity intends to offer a 10% discount on all sales during the next 30 days as part of a seasonal promotion. The 10% discount cannot be used in addition to the 40% discount voucher.

The entity estimates an 80% likelihood that a customer will redeem the voucher. The entity also estimates that a customer will, on average, purchase $50 of additional products.

Analysis

All customers receive a 10% discount on purchases during the next 30 days. Hence only the incremental discount of 30% (i.e. 40% minus 10%) provides the customer with a material right because of the original contract.

The entity accounts for the promise to provide the incremental discount as a performance obligation in the contract for the sale of Product A.

The entity’s estimated stand-alone selling price of the discount voucher is $12 ($50 average purchase price of additional products × 30% incremental discount × 80% likelihood of exercising the option).

The stand-alone selling prices of Product A and the discount voucher and the resulting allocation of the $100 transaction price are as follows:

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Stand-alone selling price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$100</td>
</tr>
<tr>
<td>Discount Voucher</td>
<td>$12</td>
</tr>
<tr>
<td>Total</td>
<td>$112</td>
</tr>
</tbody>
</table>

Allocate transaction price

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Allocate transaction price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product A</td>
<td>$89 ($100/$112*$100)</td>
</tr>
<tr>
<td>Discount Voucher</td>
<td>$11 ($12/$112*100)</td>
</tr>
<tr>
<td>Total</td>
<td>$100</td>
</tr>
</tbody>
</table>

The entity allocates $89 to Product A and recognises revenue for Product A when control transfers. The entity allocates $11 to the discount voucher and recognises revenue for the voucher when the customer redeems it for goods and services or when the voucher expires.
As a practical expedient, an entity **need not** estimate the standalone selling price of an option if (AASB 15.B43):

- the customer has a material right to acquire future goods or services
- such future goods or services are:
  - similar to the original goods or services
  - provided in accordance with the terms of the original contract.

Contract renewals could be typical examples.

In such instances, as an alternative, the total consideration expected to be received from the customer (including consideration from expected renewals) is considered as the transaction price. This should be allocated to the total goods or services (i.e. original contract plus the expected renewals).

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**Example – Practical expedient for contract renewals**

Entity Z contracts to sell 100 units of a product over 12 months at $1,000 per unit. The customer has the option to renew the contract at the end of the year for an additional 12-months. The contract renewal will be for the same product and under the same terms as the original contract. Entity Z typically increases its prices 10% each year.

**Analysis**

The renewal option represents a material right to the customer as they would get a lower price for the units than similar customers if the contract is renewed.

The future units are the same product and under the same terms as the original contract.

Consequently, as a practical expedient, the total transaction price is not required to be allocated based on the stand-alone selling price of the renewal option.

Instead, the total consideration of $200,000 (100 units X $1,000 X 2 years) is considered as the transaction price at inception. This price is allocated to the total 200 units (original units plus expected renewal) and revenue is recognised as the units are delivered to the customer.
5. Transitional Requirements and Relief

This section considers the transition guidance for revenue recognition under AASB 15. The transition requirements are contained in Appendix C to AASB 15. The following are key definitions for the purposes of transition:

- **Date of initial application** – this is the beginning of the reporting period in which an entity first applies AASB 15 i.e. 1 July 2018 (for-profits) and 1 July 2019 (NFPs).
- **Completed contract** – is a contract for which the entity has transferred all of the goods or services identified in accordance with AASB 111, AASB 118 and related Interpretations (AASB 15.C2(b)).

In other words, a completed contract is a contract in which the entity has fully performed (i.e. delivered the good or performed the service) in accordance with AASB 118, AASB 111 etc. before the date of initial application (IFRS 15.BC445D), regardless of whether revenue is still subject to variability (IFRS 15.BC441).

5.1 Transition options

**NFP entities** have two options on transition:

- **AASB 15- Transition Options (NFPs)**
  - Full retrospective
    - Restate retained earnings at 1 July
    - Restate comparatives for FY 2018/19
  - Modified retrospective
    - Restate retained earnings at 1 July 2019
    - Apply AASB 15 effective FY 2019/20

**For-profits** have the same options as above. The application date is a year earlier.

- **AASB 15- Transition Options (for-profits)**
  - Full retrospective
    - Restate retained earnings at 1 July
    - Restate comparatives for FY 2017/18
  - Modified retrospective
    - Restate retained earnings at 1 July 2018
    - Apply AASB 15 effective FY 2018/19
The full retrospective option is expected to enhance comparability, although the costs of preparing two sets of information for the year prior to implementation may outweigh the benefits.

**Practical expedients**

Under both options, it is not necessary to restate revenue from contracts that completed prior to the date AASB 15 is first applied (AASB 2016-3.C5/C7). That date is one year earlier under the full retrospective date.

There are further expedients under the full retrospective method, elaborated in the following sections.

### 5.1.1 Full retrospective approach

Under this option, the recognition and measurement principles of AASB 15 should be retrospectively applied for the current year and prior year comparatives as though AASB 15 had always applied, consistent with AASB 108 Accounting Policies, Changes in Accounting Estimates and Errors (para 22).

AASB 15 must be applied for:

- the year of implementation [FY 2018/19 (for-profits) and FY 2019/20 (NFPs)];
- the comparative information [FY 2017/18 (for-profits) and FY 2018/19 (NFPs)]; and
- in determining the adjustment to opening retained earnings/accumulated funds [as at 1 July 2017 (for-profits) and 1 July 2018 (NFPs)] for the cumulative effect of applying AASB 15 up to that date.

#### Practical expedients under this approach (AASB 2016-3.C5):

<table>
<thead>
<tr>
<th>Area</th>
<th>Expedient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completed contracts that start and complete within a financial year</td>
<td>Such contracts are not required to be restated. This means, where revenue under AASB 118/AASB 111 was recognised in the comparative financial year i.e. FY 2017/18 (for-profits) and FY 2018/19 (NFPs), these do not require restatement.</td>
</tr>
<tr>
<td>Completed contracts at the beginning of the earliest period presented</td>
<td>There is no requirement to restate completed contracts or transactions at the beginning of the earliest period presented i.e. 1 July 2017 (for-profits) and 1 July 2018 (NFPs). Use of this practical expedient eliminates the need to review completed contracts before 1 July 2017 (for-profits) and 1 July 2018 (NFPs), on which revenue is recognised under AASB 118, AASB 111 etc.</td>
</tr>
<tr>
<td>Completed contracts that have variable consideration</td>
<td>For such contracts, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting period [FY 2017/18 (for-profits) and FY 2018/19 (NFPs)].</td>
</tr>
<tr>
<td>Contracts modified before the beginning of the earliest period presented</td>
<td>For contracts modified before the beginning of the earliest period presented [FY 2017/18 (for-profits) and FY 2018/19 (NFPs)], an entity need not separately evaluate the effect of each contract modification. Instead of accounting for the effects of each contract modification separately, the entity can consider the aggregate effect of all past contract modifications when identifying the performance obligations, and determining and allocating the transaction price (IFRS 15.BC4450).</td>
</tr>
</tbody>
</table>
Area | Expedient
--- | ---
The practical expedient permits an entity to use hindsight when evaluating contract modifications in making the transition to AASB 15.
For example, if a for-profit entity (applying AASB 15 in FY 2018/19 and presenting comparative information for the year ended 30 June 2018) has a contract which was modified more than once before 1 July 2017 (i.e. the beginning of the comparative year), the entity can assess the aggregate effect of those modifications instead of each modification being accounted for individually.

5.1.2 Modified retrospective approach

Under this option, recognition and measurement principles of AASB 15 should be applied to adjust only the current year as though AASB 15 had always applied. Consequently, apply AASB 15:
- for the year of implementation [FY 2018/19 (for-profits) and FY 2019/20 (NFPs)]; and
- in determining the adjustment to opening retained earnings/accumulated funds [as at 1 July 2018 (for-profits) and 1 July 2019 (NFPs)] for the cumulative effect of applying AASB 15 up to that date

Practical expedients under this approach

- There is no requirement to restate completed contracts or transactions at the beginning of the application date i.e. 1 July 2018 (for-profits) and 1 July 2019 (NFPs).

Use of this practical expedient eliminates the need to review completed contracts before 1 July 2018 (for-profits) and 1 July 2019 (NFPs), on which revenue was recognised under AASB 118, AASB 111 etc. (AASB 15.C7).

- Entities may also use the practical expedient on contract modifications described under Section 5.1.1 above, either (AASB 2016-3.C7A):
  - for all contract modifications that occur before the beginning of the earliest period presented i.e. 1 July 2017 (for-profits) and 1 July 2018 (NFPs); or
  - for all contract modifications that occur before the date of initial application i.e. 1 July 2018 (for-profits) and 1 July 2019 (NFPs)

If an entity uses this practical expedient, the entity should apply the expedient consistently to all contracts (AASB 2016-3.C7A).
**Example – Modified retrospective approach**

Entity B (for-profit) enters into contracts to provide an intellectual property licence, professional services and post-delivery service support. Previously under AASB 118, it recognised fees from the professional services by reference to the stage of completion, which included the completion of post delivery service support. In effect, Entity B treated the professional service and post-delivery service support as a single deliverable.

**Analysis of transition implications**

Entity B’s analysis of contracts in progress as at 1 July 2018 may result in the identification of different performance obligations under AASB 15 from those it previously used for revenue recognition under AASB 118. As part of this assessment, Entity B would need to allocate the estimated transaction price, based on the relative stand-alone selling price method, to the newly identified performance obligations.

Entity B should compare the revenue recognised for each contract, from contract inception through to 30 June 2018, to the amount that would have been recognised if the entity had applied AASB 15 since contract inception.

The difference between those two amounts would be accounted for as a cumulative catch-up adjustment and recognised as at 1 July 2018 in opening retained earnings. From 1 July 2018 onwards, revenue would be recognised for these contracts based on AASB 15.

**Comparison of the transition approaches**

If Entity B had opted for full retrospective application in the above example, it would need to analyse the contracts in progress as at 1 July 2017 (beginning of the earliest comparative period).

Revenue would be determined from contract inception through to 30 June 2017 both under AASB 15 and AASB 118. The difference would be recognised as an adjustment to opening retained earnings as at 1 July 2017.

Entity B should then determine revenue for FY 2017/18 (i.e. the comparative period) based on AASB 15 and restate the comparatives for any difference.

From 1 July 2018 onwards, Entity B should continue to recognise revenue based on AASB 15.
6. Disclosures

The objective of the disclosure requirements is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. (AASB 15.110)

AASB 15 requires detailed quantitative and qualitative disclosures on a range of topics, including significant judgments in recognising and measuring revenue. The disclosure requirements are extensive and some will require significant judgment in application.

An entity should disclose revenue recognised under AASB 15 separately from its other sources of revenue. An entity should also disclose any impairment losses from any receivables or contract assets arising from AASB 15 separately from other impairment losses (AASB 15.113).

Key disclosure topics are summarised below. For detailed disclosure requirements refer to AASB 15.110-129.

**Key disclosure topics**

- Contract balances
- Performance obligations
- Significant judgements
- Costs to obtain or fulfil a contract
- Disaggregation of revenue

Disclosures on contracts with customers, significant judgements and contract costs
6.1 Disaggregation of revenue

Revenue recognised under AASB 15 should be disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors (AASB 15.114).

Examples of categories that might be appropriate include, but are not limited to (AASB 15.B89):

- type of good or service (e.g. major product lines)
- geographical region (e.g. country or region)
- market or customer type (e.g. government and non-government customers)
- type of contract (e.g. fixed-price and time-and-materials contracts)
- contract duration (e.g. short-term and long-term contracts)
- timing of transfer of goods or services (e.g. revenue transferred to customers at a point in time and revenue transferred over time)
- sales channels (e.g., goods sold directly and goods sold through intermediaries).

6.2 Contract balances

The following should be disclosed in respect of contract balances (AASB 15.116-118):

- the opening and closing balances of receivables, contract assets and contract liabilities
- revenue recognised out of the contract liability balance at the beginning of financial year
- revenue recognised from performance obligations satisfied (or partially satisfied) in previous periods e.g. changes in transaction price
- an explanation of how the entity’s contracts and typical payment terms will impact its contract asset and liability balances
- an explanation of the significant changes in the contract asset and the contract liability balances, including qualitative and quantitative information such as:
  - changes due to business combinations
  - cumulative catch-up adjustments to revenue that affect the contract asset or liability, including adjustments from a change in the measure of progress, a change in an estimate of the transaction price, or a contract modification
  - impairment of a contract asset
  - a change in the time frame for a right to consideration to become unconditional (i.e. for a contract asset to be reclassified to a receivable)
  - a change in the time frame for a performance obligation to be satisfied (i.e. for the recognition of revenue arising from a contract liability).
6.3 Performance obligations

The following information should be disclosed about performance obligations (AASB 15.119-120):

a) when the entity typically satisfies its performance obligations (e.g. upon delivery/shipment, as services are rendered or upon completion of service)
b) significant payment terms (e.g. when payment is typically due, significant financing component, variable consideration including constraints)
c) the nature of the goods or services promised, highlighting any performance obligations to arrange for another party to transfer goods or services (i.e. if the entity is acting as an agent)
d) obligations for returns, refunds and other similar obligations
e) types of warranties and related obligations
f) the aggregate transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) at the end of the financial year and a quantitative or qualitative explanation of when it expects to recognise this amount as revenue.

As a practical expedient, (f) above need not be disclosed if (AASB 15.121):

- the performance obligation is part of a contract that has an original expected duration of one year or less; or
- the entity applies the practical expedient to recognise revenue based on amounts invoiced to a customer in certain circumstances (e.g. a service contract in which an entity bills a fixed hourly amount) (AASB 15.B16)

An entity should also disclose whether it is applying the above practical expedient and whether any consideration from contracts with customers is not included in the transaction price - e.g. whether the amount is constrained and hence not included in the disclosure (AASB 15.122).

6.4 Significant judgements

- Disclose the judgements and changes to the judgements that significantly affect the determination of the amount and timing of revenue under AASB 15. In particular, explain those judgements used in determining (AASB 15.123):
  o the timing of satisfaction of performance obligations
  o the transaction price and the amounts allocated to performance obligations.
- For performance obligations satisfied over time, disclose (AASB 15.124):
  o the methods used to recognise revenue (e.g. a description of the output methods or input methods used and how those methods are applied)
  o an explanation of why the methods used provide a faithful depiction of the transfer of goods or services.
- For performance obligations satisfied at a point in time, disclose the significant judgements in evaluating when a customer obtains control of promised goods or services (AASB 15.125).
- Disclose information about the methods, inputs and assumptions used for (AASB 15.126):
  o determining the transaction price, including:
    ⇒ estimating variable consideration
    ⇒ adjusting the consideration for a significant financing component
    ⇒ measuring non-cash consideration
  o assessing whether an estimate of variable consideration is constrained.
allocating the transaction price, including:

- estimating stand-alone selling prices of promised goods or services
- allocating discounts
- allocation variable consideration

- measuring obligations for returns, refunds and other similar obligations.

### 6.5 Costs to obtain or fulfil a contract

- **Describe** (AASB 15.127):
  - judgements made in determining the costs incurred to obtain or fulfil a contract with a customer
  - the method it uses to determine the amortisation for each financial year.

- **Disclose** (AASB 15.128):
  - the closing balances of assets recognised from the costs incurred to obtain or fulfil a contract with a customer, by main category of asset (e.g., costs to obtain contracts, pre-contract costs and setup costs)
  - the amount of amortisation and any impairment losses recognised in the financial year.

### 6.6 Transition disclosures

**Full retrospective approach**

Under this approach, disclose the amount by which each financial statement line item is affected in the immediate prior year i.e. FY 2017/18 (for-profits) and FY 2018/19 (NFPs) as a result of the transition (AASB 15.C4).

As a practical expedient, for the comparative financial year i.e. FY 2017/18 (for-profits) and FY 2018/19 (NFPs), an entity need not disclose the transaction price allocated to the remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue [AASB 2016-3.C5(d)].

For any of the practical expedients used (see Section 5.1.1 above) under AASB 2016-3.C5, disclose the:

- the expedients that have been used
- to the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

**Modified retrospective approach**

Under this approach, disclose the amount by which each financial statement line item is affected in the current reporting period [FY 2018/19 (for-profits) and FY 2019/20 (NFPs)] as a result of the transition and an explanation of the reasons for significant changes due to the transition (AASB 15.C8).

If an entity uses the practical expedient on contract modifications described under Section 5.1.2 above, disclose the expedient, including a qualitative assessment of the estimated effect of applying the expedient (AASB 2016-3.C7A).