EXAMPLES AND EXERCISES

IDENTIFYING PERFORMANCE OBLIGATIONS

Example 10—Determining whether goods and services are distinct

A enters into a contract to build a hospital for a customer. A is responsible for the overall management of the project and identifies various goods and services to be provided, including engineering, site clearance, foundation, procurement, construction of the structure, piping and wiring, installation of equipment and finishing.

a) **What are the distinct goods and services?**
b) **What performance obligation(s) does A have?**

Example 11—Determining whether goods or services are distinct

Case A—Distinct goods or services

An entity, a software developer, enters into a contract with a customer to transfer a software licence, perform an installation service and provide unspecified software updates and technical support (online and telephone) for a two-year period. The entity sells the licence, installation service and technical support separately. The installation service includes changing the web screen for each type of user (for example, marketing, inventory management and information technology). The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and the technical support.

a) **What are the distinct goods and services?**
b) **What performance obligation(s) does A have?**

Case B—Significant customisation

The promised goods and services are the same as in Case A, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

a) **Is the software separately identifiable?**
b) **What performance obligation(s) does A have?**

PERFORMANCE OBLIGATIONS SATISFIED OVER TIME OR AT A POINT IN TIME

Example 13—One Year Contract

An entity enters into a contract to provide monthly payroll processing services to a customer for one year.

Is control transferred over time or at a point in time?

Example 14—Assessing alternative use and right to payment

An entity enters into a contract with a customer to provide a consulting service that results in the entity providing a professional opinion to the customer. The professional opinion relates to facts and circumstances that are specific to the customer. If the customer were to terminate the consulting contract for reasons other than the entity's failure to perform as promised, the contract requires the customer to compensate the entity for its costs incurred plus a 15 per cent margin. The 15 per cent margin approximates the profit margin that the entity earns from similar contracts.

Is control transferred over time or at a point in time?

Example 15—Asset has no alternative use to the entity

An entity enters into a contract with a customer, a government agency, to build a specialised satellite. The entity builds satellites for various customers, such as governments and commercial entities. The design and construction of each satellite differ substantially, on the basis of each customer's needs and the type of technology that is incorporated into the satellite.

At contract inception, the entity assesses whether its performance obligation to build the satellite is a performance obligation satisfied over time in accordance with paragraph 35 of IFRS 15.

Is control transferred over time or at a point in time?

Example 16—Enforceable right to payment for performance completed to date

An entity enters into a contract with a customer to build an item of equipment. The payment schedule in the contract specifies that the customer must make an advance payment at contract inception of 10 per cent of the contract price, regular payments throughout the construction period (amounting to 50 per cent of the contract price) and a final payment of 40 per cent of the contract price after construction is completed and the equipment has passed the prescribed performance tests. The payments are non-refundable unless the entity fails to perform as promised. If the customer terminates the contract, the entity is entitled only to retain any progress payments received from the customer. The entity has no further rights to compensation from the customer.

At contract inception, the entity assesses whether its performance obligation to build the equipment is a performance obligation satisfied over time in accordance with paragraph 35 of IFRS 15.

Is control transferred over time or at a point in time?

MEASURING PROGRESS TOWARDS COMPLETE SATISFACTION OF A PERFORMANCE OBLIGATION

Example 18—Measuring progress when making goods or services available

An entity, an owner and manager of health clubs, enters into a contract with a customer for one year of access to any of its health clubs. The customer has unlimited use of the health clubs and promises to pay CU100 per month.

a) **Is control transferred over time or at a point in time?**
b) **How should the entity measure progress towards completion?**

VARIABLE CONSIDERATION

Example 20—Penalty gives rise to variable consideration

An entity enters into a contract with a customer to build an asset for CU1 million. In addition, the terms of the contract include a penalty of CU100,000 if the construction is not completed within three months of a date specified in the contract.

The entity concludes that the consideration promised in the contract includes a fixed amount of CU900,000 and a variable amount of CU100,000 (arising from the penalty).

The entity estimates the variable consideration in accordance with paragraphs 50–54 of IFRS 15 and considers the requirements in paragraphs 56–58 of IFRS 15 on constraining estimates of variable consideration.

ALLOCATING THE TRANSACTION PRICE TO PERFORMANCE OBLIGATIONS

Example 33—Allocation methodology

An entity enters into a contract with a customer to sell Products A, B and C in exchange for CU100. The entity will satisfy the performance obligations for each of the products at different points in time. The entity regularly sells Product A separately and therefore the stand-alone selling price is directly observable. The stand-alone selling prices of Products B and C are not directly observable.

Because the stand-alone selling prices for Products B and C are not directly observable, the entity must estimate them. To estimate the stand-alone selling prices, the entity uses the adjusted market assessment approach for Product B and the expected cost plus a margin approach for Product C. In making those estimates, the entity maximises the use of observable inputs (in accordance with paragraph 78 of IFRS 15). The entity estimates the stand-alone selling prices as follows:

Product	Stand-alone selling price (in Currency Units)	Method
Product A	50	Directly observable
Product B	25	Adjusted market assessment approach
Product C	75	Expected cost plus a margin approach
Total	**150**	

Calculate and allocate the discount among the products

CONTRACT COSTS

Example 36—Incremental costs of obtaining a contract

An entity, a provider of consulting services, wins a competitive bid to provide consulting services to a new customer. The entity incurred the following costs to obtain the contract:

	CU
External legal fees for due diligence	15,000
Travel costs to deliver proposal	25,000
Commissions to sales employees	10,000
Total costs incurred	50,000

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract arising from the commissions to sales employees because the entity expects to recover those costs through future fees for the consulting services. The entity also pays discretionary annual bonuses to sales supervisors based on annual sales targets, overall profitability of the entity and individual performance evaluations. In accordance with paragraph 91 of IFRS 15, the entity does not recognise an asset for the bonuses paid to sales supervisors because the bonuses are not incremental to obtaining a contract. The amounts are discretionary and are based on other factors, including the profitability of the entity and the individuals' performance. The bonuses are not directly attributable to identifiable contracts.

The entity observes that the external legal fees and travel costs would have been incurred regardless of whether the contract was obtained. Therefore, in accordance with paragraph 93 of IFRS 15, those costs are recognised as expenses when incurred, unless they are within the scope of another Standard, in which case, the relevant provisions of that Standard apply.

Example 37—Costs that give rise to an asset

An entity enters into a service contract to manage a customer's information technology data centre for five years. The contract is renewable for subsequent one-year periods. The average customer term is seven years. The entity pays an employee a CU10,000 sales commission upon the customer signing the contract. Before providing the services, the entity designs and builds a technology platform for the entity's internal use that interfaces with the customer's systems. That platform is not transferred to the customer, but will be used to deliver services to the customer.

Incremental costs of obtaining a contract

In accordance with paragraph 91 of IFRS 15, the entity recognises an asset for the CU10,000 incremental costs of obtaining the contract for the sales commission because the entity expects to recover those costs through future fees for the services to be provided. The entity amortises the asset over seven years in accordance with paragraph 99 of IFRS 15, because the asset relates to the services transferred to the customer during the contract term of five years and the entity anticipates that the contract will be renewed for two subsequent one-year periods.

CUSTOMER OPTIONS FOR ADDITIONAL GOODS OR SERVICES

Example 52—Customer loyalty programme

An entity has a customer loyalty programme that rewards a customer with one customer loyalty point for every CU10 of purchases. Each point is redeemable for a CU1 discount on any future purchases of the entity's products. During a reporting period, customers purchase products for CU100,000 and earn 10,000 points that are redeemable for future purchases. The consideration is fixed and the stand-alone selling price of the purchased products is CU100,000. The entity expects 9,500 points to be redeemed. The entity estimates a stand-alone selling price of CU0.95 per point (totalling CU9,500) on the basis of the likelihood of redemption in accordance with paragraph B42 of IFRS 15.

The points provide a material right to customers that they would not receive without entering into a contract. Consequently, the entity concludes that the promise to provide points to the customer is a performance obligation. The entity allocates the transaction price (CU100,000) to the product and the points on a relative stand-alone selling price basis as follows:

	CU
Product	91,324[CU100,000 × (CU100,000 stand-alone selling price ÷ CU109,500)]
Points	8,676[CU100,000 × (CU9,500 stand-alone selling price ÷ CU109,500)]

At the end of the first reporting period, 4,500 points have been redeemed and the entity continues to expect 9,500 points to be redeemed in total. The entity recognises revenue for the loyalty points of CU4,110 [(4,500 points ÷ 9,500 points) × CU8,676] and recognises a contract liability of CU4,566 (CU8,676 – CU4,110) for the unredeemed points at the end of the first reporting period.

At the end of the second reporting period, 8,500 points have been redeemed cumulatively. The entity updates its estimate of the points that will be redeemed and now expects that 9,700 points will be redeemed. The entity recognises revenue for the loyalty points of CU3,493 {[(8,500 total points redeemed ÷ 9,700 total points expected to be redeemed) × CU8,676 initial allocation] – CU4,110 recognised in the first reporting period}. The contract liability balance is CU1,073 (CU8,676 initial allocation – CU7,603 of cumulative revenue recognised).

NON-REFUNDABLE UPFRONT FEES

Example 53—Non-refundable upfront fee

An entity enters into a contract with a customer for one year of transaction processing services. The entity's contracts have standard terms that are the same for all customers. The contract requires the customer to pay an upfront fee to set up the customer on the entity's systems and processes. The fee is a nominal amount and is non-refundable. The customer can renew the contract each year without paying an additional fee.

The entity's setup activities do not transfer a good or service to the customer and, therefore, do not give rise to a performance obligation.

The entity concludes that the renewal option does not provide a material right to the customer that it would not receive without entering into that contract (see paragraph B40 of IFRS 15). The upfront fee is, in effect, an advance payment for the future transaction processing services. Consequently, the entity determines the transaction price, which includes the non-refundable upfront fee, and recognises revenue for the transaction processing services as those services are provided in accordance with paragraph B49 of IFRS 15.