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Project	**Revenue Recognition**		
Paper topic	Constraining the cumulative amount of revenue recognised		

CONTACT(S)	Gary Berchowitz	gberchowitz@ifrs.org	+44 20 7246 6914
	Brian Schilb	bjschilb@fasb.org	+1 203 956 3447

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Purpose of this paper

1. This paper considers possible improvements in response to feedback obtained on the proposed constraint on the cumulative amount of revenue recognised that would apply if the amount of consideration to which an entity expects to be entitled is variable ("the constraint"). The constraint was proposed in paragraphs 81-85 of the Boards' revised exposure draft *Revenue from Contracts with Customers* ("the 2011 ED").

2. This paper does not address the following aspects related to the constraint because there are related issues that are planned to be discussed at future meetings. The staff therefore plan to bring the following issues back to the Board in a separate paper once the related issues have been discussed:

   (a) paragraph 85 of the 2011 ED (the explicit guidance for licenses of intellectual property). We will bring this back to the Boards when the Boards discuss the satisfaction of performance obligations related to licenses; and

   (b) cost recognition associated with a transaction where the corresponding revenue has been constrained, which was specifically identified as a

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concern by preparers in the asset manager industry. We will bring this back to the Boards when the Boards discuss whether the 2011 ED proposals should continue to apply to gain recognition for sales of non-financial assets (Question 6 of the 2011 ED).

(c) specific disclosure requirements that might be useful to include related to the constraint. This will be addressed as part of the Boards' discussions on disclosure requirements.

3. The paper does not consider the issues arising from the feedback received on customer credit risk (Question 2 of the 2011 ED). Although customer credit risk can affect the ultimate amount of cash that an entity receives from the customer in exchange for promised goods or services, accounting for customer credit risk is considered separately in Agenda papers 7B/162B (about collectability) and 7C/162C (about seller-based financing).

Staff recommendation

4. The staff recommend that the Boards make the following refinements to the constraint from the 2011 ED:

   (a) clarify when the constraint applies by clarifying the meaning of 'variable consideration' in paragraph 53 of the 2011 ED, specifically by explaining that the term 'contingencies' can apply to uncertain price adjustments as well as uncertain events;

   (b) remove reference to the term 'reasonably assured' in paragraph 81 of the 2011 ED;

   (c) amend the guidance for understanding when an entity's experience is predictive. The staff agree on the principle, but have alternative views on the approach for achieving the principle (as described fully in paragraphs 57-58; and

(d) clarify how the constraint applies if the transaction price includes an explicit or implicit minimum plus variable consideration.

5. We have included draft wording, in Appendix A to this paper, illustrating how we think the staff recommendations might affect the corresponding paragraphs of the 2011 ED.

Structure of the paper

6. This paper is organised as follows:

    (a) Background (paragraphs 7 – 12)

    (b) Feedback from the 2011 ED (paragraphs 13 – 21)

    (c) Staff analysis

        (i) Objective of the constraint (paragraphs 22 – 26)

        (ii) Issue 1: What is considered to be variable consideration (paragraphs 27 – 33)

        (iii) Issue 2: Understanding when an entity's experience is predictive (paragraphs 34 – 48)

        (iv) Issue 3: Interaction with the measurement of the transaction price (paragraphs 61 – 74)

    (d) Appendices

        (i) Appendix A: Possible amendments to the 2011 ED

        (ii) Appendix B: Extract from March 2011 Board meeting agenda paper 10E/140E

        (iii) Appendix C: Illustrative examples

Background

7. The concept of a constraint was included in the June 2010 exposure draft, *Revenue from Contracts with Customers* ("the 2010 ED") to address concerns about recognizing revenue when significant uncertainties exist about the amount of consideration to which the entity expects to be entitled.

8. The 2010 ED restricted the inclusion of variable consideration in the estimate of the transaction price (to be measured at the amount the entity expected to receive) unless the entity had experience with similar types of contracts and that experience was relevant to the contract. Some respondents noted the following concerns with the 2010 proposals:

   (a) constraining the transaction price would not always result in a pattern of revenue recognition that would faithfully depict the performance under the contract, in particular in the asset manager and hospitality industries (refer to Appendix B which includes an extract from agenda paper 10E/140E from the March 2011 board meeting where this was explained in detail);

   (b) if the transaction price is constrained, the remaining performance obligations may be identified as onerous even though the entity expects those performance obligations to be profitable; and

   (c) the criteria for when revenue should be constrained would require an entity to recognize revenue when factors outside of the entity's control could substantially affect the amount of revenue recognised, particularly in many sales-based royalties that apply to licenses of intellectual property.

9. In the 2011 ED, the Boards made two changes to the constraint to address the those concerns:

   (a) The first change was to move the constraint from being a limitation on the transaction price (step 3 of the model) to require application to the cumulative amount of revenue recognised (we think of this as a second requirement of step 5 of the model). This change addressed the issues relating to the pattern of revenue recognition and the onerous test.

(b) The second change was the addition of an explicit requirement contained in paragraph 85 of the 2011 ED to address the concern related to sales-based royalties on intellectual property. Paragraph 85 of the 2011 ED states that if an entity licenses intellectual property to a customer and the customer promises to pay an amount of consideration that varies on the basis of the customer's subsequent sales of a good or service (for example, a sales-based royalty), the entity should not recognize revenue until the uncertainty is resolved (that is, when the customer's subsequent sales occur).

How the constraint applies in the 2011 ED

10. The constraint proposed in the 2011 ED is intended to apply to contracts in which the amount of consideration to which the entity expects to be entitled is variable. The constraint would then apply as follows:
    (a) The transaction price is estimated (step 3 of the model) using the method that best predicts the amount consideration to which the entity will be entitled, ie expected value or most likely outcome. The determination of the transaction price in step 3 is not subject to the constraint.
    (b) The entity allocates the transaction price to the performance obligations based on their relative stand-alone selling prices (step 4 of the model).
    (c) After the entity satisfies a performance obligation, the cumulative amount of the transaction price that is recognised as revenue is *limited* to only those amounts that are *predictive of the consideration that the entity will be entitled to* from satisfying the related performance obligation. In other words, step 5 of the model addresses both the:
        (i) *timing of revenue recognition*, ie an entity recognises revenue when it satisfies the related performance obligation; and
        (ii) *amount of revenue that can be recognised*, ie an entity can only recognise revenue for variable consideration up to the amounts to which it expects to be entitled to.

11. As explained above, the constraint limits the amount of the transaction price that can be recognised as revenue when an entity satisfies a performance obligation. Although not explicitly stated in the 2011 ED, the constraint acts like a recognition hurdle that applies only when the promised consideration is variable. In step 5, if the transaction price that is allocated to a performance obligation includes variable consideration, an entity would recognise revenue when it has satisfied its performance obligation *and* is able to predict the amount of the variable consideration to which the entity expects to be entitled in exchange for that good or service. Consequently although the constraint does not impact whether a performance obligation is satisfied, it might still impact when revenue can be recognised if the consideration allocated to the satisfied performance obligation is variable.
12. However, step 5 of the 2011 ED does not consider collectability when determining if revenue can be recognised. This is because the Boards decided that the transaction price that is allocated to separate performance obligations should be based on the amount to which an entity *expects to be entitled* rather than the amount that the entity expects to receive (which was proposed in the 2010 ED), for the reasons explained in paragraphs BC163-BC173 in of the Basis for Conclusions to the 2011 ED. The issue of collectability will be addressed in agenda paper 7B/162B.

Feedback on the 2011 ED

13. Question 3 in the 2011 ED asked respondents whether they agree with the proposal to constrain revenue recognition when the amount of consideration is variable.
14. Most respondents agreed in principle with the need for a constraint in the revenue model, and many broadly agreed with the principles proposed to apply the constraint (that is, when the entity has predictive experience).
15. However, many respondents requested further clarity on when and how the constraint should be applied. In particular, those respondents requested that the Boards clarify:

(a) the scope of the constraint, in particular when the transaction price is considered to be variable;

(b) the application of the constraint and how an entity would practically apply the indicators in paragraph 82 of the 2011 ED to determine whether the entity's experience would be considered to be predictive;

(c) how the measurement of the transaction price in step 3 of the model would affect the amount of variable consideration that can be recognised when applying the constraint; and

(d) the reason why there was a specific exception included in the 2011 ED that always precluded revenue recognition in advance of the subsequent sale for licenses of intellectual property where the consideration was a sales-based royalty (paragraph 85 of the 2011 ED).

16. Some respondents requested that the Boards consider the related cost recognition when an entity has satisfied performance obligations but has not recognised revenue as a result of the constraint.

17. Many respondents commented on the confusion caused by the use of the term 'reasonably assured'. Those respondents observed that the term is used elsewhere in IFRSs, US GAAP and auditing requirements, and further noted that the meaning is often different than the qualitative assessment the Boards intended in the exposure draft. Respondents suggested that the Boards either re-draft the section to avoid the use of any term or select another term that is not used elsewhere in accounting or auditing requirements.

18. The staff notes that the term 'reasonably assured' is not relevant for the purposes of applying the constraint because paragraph 81 of the 2011 ED *defines* when an entity is 'reasonably assured', by reference to whether the entity has predictive experience. In other words, the term reasonably assured could have been replaced with any term, such as 'determinable', 'reliably measured' or even 'comfortable' and it would not have made a difference to the way in which the constraint is intended to apply.

19. Consequently, the staff recommends that the Boards delete reference to the term 'reasonable assured'.

20. Because there was limited user feedback through the comment letter responses, the staff performed extensive user outreach to better understand users' needs and concerns related to the constraint. In summary the majority of users surveyed held the following views with respect to the constraint:

    (a) users are interested in the revenue recognised being a predictor of the amount the entity is entitled to from providing its goods and services;

    (b) if the entity cannot provide a revenue amount that is predictive of the amount the entity will be entitled to but the entity is very confident of a minimum amount, the entity should recognise this minimum amount as revenue; and

    (c) users would prefer a high degree of confidence by the entity before the entity recognises any portion of revenue related to variable consideration. For example, in arrangements where an entity offers the potential for significant future rebates, credits, or price concessions, revenue should be deferred until the ultimate sale price is known and cash is received. In arrangements with variable consideration such as bonuses and performance based fees, revenue should be deferred until the bonus is earned or the performance hurdle has been reached (and cannot be clawed back).

21. The staff also received feedback from some regulators, whose main concern relates to the level of judgement that is required in the 2011 ED and that the constraint therefore might not be applied consistently. However, the majority of audit firms' responses do not identify this as a concern.

Staff Analysis

The objective of the constraint

22. Before analysing the issues raised by constituents, we thought it would be helpful to first consider if there was an objective for the constraint that would help us in proposing our recommendations.

23. We think that the previous work done by the Boards in considering the measurement of the transaction price and feedback from users is a key factor when considering the constraint. In the 2010 ED, the Boards proposed using only an expected value approach to determining the transaction price. However, many respondents to the 2010 ED disagreed with the proposal because they thought it would:

    (a) be complex and costly to apply; and

    (b) not generate meaningful results in all circumstances because, for example, it could result in an entity determining a transaction price in an amount of consideration that the entity could never actually receive under the contract.

24. During the re-deliberations of the 2010 ED, the Boards observed that users are most interested in knowing the total amount of consideration that the entity will ultimately be entitled to from the contract. Consequently, the Boards modified the measurement objective for determining the transaction price in the 2011 ED; the objective is for an entity to use an approach that best predicts the consideration to which the entity will be entitled under the contract, ie either an expected value or most likely outcome. Consequently, paragraph 55 of the 2011 ED requires an entity to determine the transaction price using either an expected value or most likely outcome approach, whichever is the better predictor of the consideration that the entity will be entitled to.

25. We think the constraint is an extension of this principle. Specifically, we think that the objective of the constraint is to ensure that when a performance obligation has been satisfied but there is a reasonable chance that the ultimate amount of

revenue will be significantly different from the transaction price allocated to that performance obligation, a user would be better off if the entity only recognised revenue up to the amount that it has predictive experience that it will be entitled to. This concept was initially expressed by the staff to the Boards at the February 2011 Board meeting in agenda paper 2A (memo 1A):

> However, the minimum amount in the range might be the most useful measure available if all of the more central estimates are too uncertain to be relevant, ie if there is an extremely high degree of uncertainty about both the upper limit of the range *and* the probabilities of the various outcomes within the range.

26. Another important consequence of this analysis is that an entity should use the same inputs as those used in determining the transaction price when applying the constraint because the measurement objective for determining the transaction price and applying the constraint are the same, ie predicting the amount of consideration the entity will be entitled to for providing its goods or services. For example, if an entity used a most likely outcome approach on a single contract to determine the transaction price, the entity would use the same inputs and unit of account when determining the application of the constraint.

Issue 1: What is considered to be variable consideration

27. Paragraph 81 of the 2011 ED states that the constraint applies to variable consideration. The 2011 ED does not define variable consideration but paragraph 53 in the 2011 ED includes a list of what would be considered variable:

> The promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions or other similar items.

28. Some respondents raised questions about what type of amounts the Boards would consider to be ‘variable’. Those questions suggest that there is some confusion

about the meaning of variable consideration. In particular, respondents appeared to be confused by the term 'contingencies' in paragraph 53 of the 2011 ED and whether the constraint could ever apply to fixed consideration. Those respondents requested the Boards to clarify the definition of variable consideration by clarifying the meaning of the term 'contingencies' as it relates to variable consideration.

29. As explained in paragraph 22 - 26 above, we think that the objective of the constraint is to ensure that an entity provides a revenue amount to users that will be a good predictor of the amount of consideration that the entity will be entitled to.

30. Consequently, we think that regardless of whether the consideration is 'fixed' or 'variable', the constraint should apply if there is sufficient uncertainty around the amount to which the entity will ultimately be entitled. For example:

> An entity enters into a contract with a customer to provide legal services (a single performance obligation satisfied over time). The entity works on a 'no-win, no-fee' basis. In other words, if the court decision is not in favour of the customer, the entity will receive no consideration. However, if the entity is successful, it will be entitled to a fixed fee of CU200,000. At year end, after one year of court proceedings, the entity is reasonably confident of a positive outcome in the following year.
>
> *Staff analysis*
>
> The entity determines the transaction price (step 3) using the most likely outcome approach, ie the transaction price is CU200,000. The entity has partially satisfied its performance obligation (step 5).
>
> However, the amount of consideration to which the entity will be entitled is not reasonably assured because the amount of consideration is highly susceptible to factors outside of the entity's influence (2011 ED para 82(a)). Consequently, the constraint applies and no revenue would be recognised until the uncertainty is resolved.

31. Some respondents also interpreted 'contingencies' to be limited to consideration that is dependent on events outside of the control of the entity (to be consistent

with the definition of contingent assets in *IAS 37 Provisions, Contingent Liabilities and Contingent Assets*), even though that did not appear to be what the Boards intended because performance bonuses may be within the entity's control and are included in the list of variable consideration in paragraph 53 of the 2011 ED.

32. Consequently, we think the issue can be addressed by clarifying that for the purposes of applying the constraint, an entity should consider the guidance in paragraph 53 of the 2011 ED when determining if the consideration is variable. In addition, we think that the explanation of variable consideration in paragraph 53 could be clarified by using a term other than 'contingencies' which already is used elsewhere in IFRSs and US GAAP and clarifying that the contingencies can relate to both prices and events.

33. We recommend that:
    - (a) There should be an explicit reference from paragraph 81 of the 2011 ED to paragraph 53 to clarify the scope of the constraint for 'variable consideration'.
    - (b) The word 'contingencies' in paragraph 53 of the 2011 ED should be replaced with 'uncertain events' to eliminate confusion as to whether it is intended to be consistent with contingencies in other areas of IFRS and US GAAP.
    - (c) An additional paragraph immediately following Paragraph 53 of the 2011 ED should be added to clarify that uncertain events can either relate to:
        - (i) uncertainties affecting the price: uncertainties where an entity has the right to obtain consideration and the amount to which the entity will be entitled varies depending on subsequent events or other variables. However, the right to obtain consideration is not contingent; and
        - (ii) uncertainties related to events: uncertainties where the entity's right to obtain consideration is contingent on the occurrence or non-occurrence of uncertain future events. The outcome of the events

could be within the entity's control, the customer's control, or neither.

Issue 2: Understanding when an entity's experience is predictive

34. An entity is permitted to recognise revenue for satisfied performance obligations only when the entity has predictive experience (or other evidence) of the amount of consideration to which the entity will be entitled.

35. Paragraphs 82-83 of the 2011 ED provide guidance about whether an entity's experience (or other evidence) *is* predictive of the amount of consideration to which the entity will be entitled.

36. However some regulators and users still have concerns related to the application of the constraint. For example, one regulator stated that:

> ESMA notes that the indicators presented in paragraph 82 where the entity's experience is not predictive are the same as those in the 2010 ED. Those indicators are highly discretionary. Even more surprisingly, paragraph 83 asserts that the existence of any of those listed indicators does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration, when considering all facts and circumstances and using judgment.
>
> ESMA believes that paragraph 83 does not ensure consistent application of recognising revenue in case the entity is not reasonably assured to be entitled to that revenue. ESMA believes that the indicators in paragraph 82 as well as the indication that all facts and circumstances should be considered in paragraph 83 are not decisive and need a lot of management judgement to decide whether to recognise revenue or not. (CL #288)

37. We think that the options available for addressing this issue are:

(a) *Option 1 – 2011 ED qualitative assessment:* Retain the qualitative assessment in the 2011 ED by reinforcing the principle in paragraph 81 and retaining the indicators in paragraph 82.

(b) *Option 2 – determinative approach:* Amend the guidance in paragraph 82 of the 2011 ED to provide an objective and determinative methodology to ensure that revenue is not recognised when there are a broad range of possible consideration amounts.

(c) *Option 3 – confidence threshold*: Retain the 2011 ED indicators in paragraph 82 and introduce a threshold for the level of confidence an entity must have when assessing whether or not the entity's experience is predictive.

38. The staff did not reconsider options that were previously considered by the Boards and for which there has been no new information or thinking that would change the previous Board conclusions. For example, what some call the US GAAP "contingent cash cap" alternative (refer to ASC 605-25) was previously deliberated by the Boards, but rejected as explained in paragraphs BC193-197 of the 2011 ED.

39. Regardless of the option the Boards choose, we think that additional illustrative examples should be provided to help clarify the application of the constraint. We think the issue of any specific disclosure about when and why the constraint has been applied should be considered when the Boards redeliberate the disclosure requirements for this standard.

Option 1 – 2011 ED qualitative assessment

40. This approach establishes a qualitative assessment that entities would perform to determine if the variable consideration should be constrained. This approach would require an amendment to paragraph 81 to outline the qualitative principle (and the deletion of the phrase 'reasonably assured' as explained in paragraph 19 above). The indicators in paragraph 82 and guidance in 83 would remain unchanged.

41. Paragraph 81 could be amended as follows:

> If the transaction price allocated to a performance obligation is variable (as explained in paragraph 53), an entity shall recognise revenue for satisfied performance obligations only when the entity has predictive experience of the amount of consideration to which the entity will ultimately be entitled. This assessment is qualitative and considers both the possibility and magnitude of the estimated transaction price allocated to the satisfied performance obligation being different from the consideration to which the entity will ultimately be entitled once the uncertainty has been resolved. An entity has predictive experience only if both of the following criteria are met… *(remainder of paragraphs 81-83 unchanged)*

42. The benefits of this approach are:
    (a) it may provide greater transparency to the exchange transaction when satisfied by the entity as revenue may be recognised when it is predictive of the entity's experience;
    (b) it is principles-based and allows entities flexibility to apply the guidance to achieve the objective of the constraint; and
    (c) many respondents (including auditors) did not raise concerns with the guidance in paragraph 82 of the 2011 ED.
43. The disadvantages of this approach are:
    (a) it will not address the issue raised by those constituents, including several users and regulators, that requested the robustness of the requirements of the constraint be enhanced to achieve consistent application;
    (b) it will not address the requests for more clarity as to the Boards' intent for the quality of the information, for example, "what level of confidence should I be aiming for?"; and
    (c) if regulators do not think the guidance is sufficient to achieve consistent application, they might provide their own interpretations which may not be consistent with the Boards' intention or consistent between regulators.

Option 2 – Determinative approach

44. This option would amend paragraph 82 of the 2011 ED by providing an objective and determinative methodology to ensure that revenue is not recognised when there are a broad range of possible consideration amounts. This places more emphasis on the indicator provided in paragraph 82(d) of the 2011 ED and provides a determinative framework for entities to make the assessment of whether to constrain revenue. In other words, the indicators in paragraph 82 would be incorporated into an approach whereby an entity would *not* recognise revenue for satisfied performance obligations if:
    (a) there are outcomes that would result in a significantly different amount of consideration from that determined as the transaction price in step 3; and
    (b) those outcomes have a reasonable possibility of occurring.

45. We think that the way in which an entity would apply the methodology explained in the preceding paragraph is as follows:
    (a) The entity determines the transaction price (step 3). As explained in paragraph 55 of the 2011 ED, an entity determines the transaction price using either an expected value or most likely outcome, whichever is more predictive of the amount of consideration that the entity will be entitled to. As explained in paragraph 55 of the 2011 ED, the methodology used is not a free choice:

    > To estimate the transaction price, an entity shall use either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:
    >
    > (a) The expected value—the expected value is the sum of probability weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the transaction price if an entity has a large number of contracts with similar characteristics.

> (b) The most likely amount—the most likely amount is the single most likely amount in a range of possible consideration amounts (ie the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the transaction price if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

(b) When the entity satisfies a performance obligation (step 5), the entity determines if the consideration allocated to that performance obligation is variable.

(c) If the consideration is variable, before an entity can recognise revenue the entity:

   (i) determines if there were other outcomes that had a reasonable possibility of occurring when it determined the transaction price, using the same inputs and methodology that were used when determining the transaction price (for example portfolio or individual contract).

   (ii) if there were other outcomes that had a reasonable possibility of occurring, the entity then determines whether the amount of consideration that would result from those reasonably possible outcomes differs significantly from the allocated transaction price as determined in step 3.

   (iii) if there are outcomes with a reasonable possibility of occurring that differ significantly from the allocated transaction price, the entity would be precluded from recognising all of the allocated revenue for satisfying the performance obligation.

46. We have included several examples in Appendix C to this paper to illustrate the application of this option as compared to the other options. An example of the wording that could replace paragraphs 81-83 of the 2011 ED could be something similar to the following:

81. If the transaction price allocated to a performance obligation is variable (as explained in paragraph 53), an entity shall recognise revenue for satisfied performance obligations only when the entity has predictive experience of the amount of consideration to which the entity will ultimately be entitled. This assessment is qualitative and considers both the possibility and magnitude of the estimated transaction price allocated to the satisfied performance obligation being different from the consideration to which the entity will ultimately be entitled once the uncertainty has been resolved. An entity has predictive experience only if both of the following criteria are met: (*these criteria would be unchanged from 2011ED)*:

a) the entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities); and

b) the entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations

82. An entity's experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled if:

a) there are outcomes that would result in a significantly different amount of consideration from that determined as the transaction price allocated to the satisfied performance obligation; and
b) those outcomes have a reasonable possibility of occurring.

82.2 In some cases, an entity will not need to perform a detailed analysis when it is clear from the entity's

experience (or other evidence) that there are reasonably possible outcomes that are significantly different from the transaction price, for example when the amount of consideration is highly susceptible to factors outside of the entity's influence.

47. The advantages of applying option 2 are:
    (a) the application of the constraint is aligned with the objective of the constraint (as explained in paragraphs 22-26 above);
    (b) the application of the constraint would be more robust and determinative because if there was doubt as to whether an entity had predictive experience, an entity could prepare an analysis based on relevant experience that demonstrated why the allocated transaction price was predictive;
    (c) it does not fundamentally change the way in which paragraph 82-83 were intended to be applied. In other words, the indicators in paragraph 82 of the 2011 ED will be incorporated into the determinative approach. For example, we think that in most cases, the factors in paragraph 82(a) would result in there being reasonably possible outcomes that are significantly different from the transaction price. Consequently the constituents who were comfortable with the principles of the 2011 ED should also be comfortable with the revision; and
    (d) by not prescribing the level of confidence that an entity needs to achieve, it allows entities to apply a level of judgement to achieve the objective of the constraint.
48. The disadvantages of option 2 are:
    (a) because terminology such as "significantly different" and "reasonable chance of occurring" will not be defined, entities may not be clear on how to apply the requirements of the revised wording and consequently the guidance will be applied inconsistently;

(b) although the proposed revision is determinative (unlike indicators), without specifying the level of confidence that an entity needs to have to overcome the constraint, some may argue that option 2 does not address the concern raised by some users and regulators who requested that the application of the constraint be made more robust; and

(c) this approach may require education to help preparers understand how it should be applied.

Option 3 – Confidence threshold

49. This option would amend the guidance in paragraph 82 of the 2011 ED to make the determination more prescriptive by specifying a level of confidence that an entity needs to achieve before the entity can recognise revenue for a satisfied performance obligation where the consideration allocated to the performance obligation is variable. This approach carries forward significant aspects of the 2011 ED but provides a 'target' against which entities may assess their predictive information.

50. This option could be achieved by using a descriptive term in the standard and explaining, in the Basis for Conclusions, the broad level of confidence that the Boards intend the term to represent. The term used to describe the level of confidence would need to be a term that is not currently used under IFRS or US GAAP, otherwise there is a risk that confusion will arise as it did from the use of the term 'reasonably assured' in the 2011 ED (refer to issue 1 above).

51. The revised wording that could replace paragraph 82 of the 2011 ED could broadly be as follows, where "highly" could be modified as discussed in paragraph 54 below:

> An entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled if the entity is [highly] confident that it will be entitled to that portion of the allocated transaction price.

Factors that an entity shall consider in determining its level of confidence include, but are not limited to, the following… (*remainder of paragraph 82 indicators unchanged)*

52. The advantages of applying a threshold include:
    (a) Constituents' ability to understand and apply the guidance consistently. Although a significant amount of judgment would still be required, constituents are familiar with applying the concept of thresholds in revenue recognition currently;
    (b) It responds to the requests for clarity on the level of confidence an entity needs to achieve to comply with the principle outlined by the qualitative assessment.
    (c) it will increase the robustness of the application of the constraint guidance, which was the request from the constituents who had a concern with the wording in the 2011 ED.
53. The disadvantages associated with using a threshold include:
    (a) the choice of the quantitative range for the threshold would be arbitrary and the Boards would need to agree on this range;
    (b) an entity's determination of the percentage of confidence will still be subject to judgement. In other words, if for example the Boards chose a range of 70%-80% as the level of confidence, an entity would still need to apply its judgement in determining whether it achieves that confidence level; and
    (c) the introduction of a threshold is a different concept to that in the 2011 ED which was qualitative. The Boards would need to consider whether this change would be something that would require further outreach because many respondents (including auditors) were supportive of only the qualitative approach in the 2011 ED.
54. If the Boards decided that option 3 was the best approach, the Boards would need to decide what minimum level of confidence should exist before an entity can demonstrate predictive experience, for example:

Option	Threshold	Confidence Range (%)
3A	Reasonably confident	Approximately 70% - 80%
3B	Highly confident	Approximately 80%-90%

55. The staff also considered an alternative that would include a lower level of confidence, more likely than not, which is a commonly defined confidence level in U.S. GAAP and IFRS. However, based on feedback from those constituents who requested a level of confidence, we do not recommend pursuing this lower level of confidence.

56. If the Boards decided option 3 was the best approach, we think the best alternative is 3B, a high level of confidence. Additionally, in order to achieve the desired level of consistency in this approach the staff recommend the Boards explain in the Basis for Conclusions that the term used is intended to be a high level of confidence (in the range of 80% - 90%) because the majority of users' responses suggested that users want a high degree of certainty before uncertain consideration is recognised as revenue..

57. We have included some illustrative examples in Appendix C to demonstrate how we think each of the three options would apply to some common fact patterns.

58. In reaching our staff recommendation, the staff note there are several common elements in the improvements proposed in the options presented. Overall, the staff is in agreement with many of these common elements, specifically:
    (a) Improving the consistent application of the constraint in the final standard by clarifying the objective of the constraint.
    (b) Improving and/or reinforcing the robustness of the requirements of the constraint
    (c) Establishing a constraint that is effective and practical in which preparers can comply, auditors can assess, users can understand the results and regulators can enforce
    (d) Acknowledging that judgement is present in all constraint assessments and the standard should assist constituents in applying that judgment

59. In assessing the preferred option, considering the overall similar elements outlined above, some staff prefer Option 2 while other staff prefer Option 3. Both options include the following common improvements :
    (a) They clarify the objective of the constraint.
        (i) Option 2 achieves this by clarifying qualitatively the objective of the constraint in paragraph 81.
        (ii) Option 3 achieves this by clarifying an approximate level of assurance that an entity needs to recognise uncertain consideration.
    (b) They improve the robustness of the requirements of the constraint to improve consistent application.
        (i) Option 2 amends paragraph 82 to incorporate the indicators into a determinative approach where an entity could apply an analysis depending on the level of judgement and uncertainty involved. Consequently, an entity could objectively assess whether or not there is too much uncertainty in the consideration, thereby improving the robustness of the model.
        (ii) Option 3B amends paragraph 82 to require a high threshold level of confidence in the predictive nature of the information used to assess whether or not entity is entitled to such amount at a reporting period end date. Consequently, an entity would better understand the level of confidence it needed to achieve to recognise uncertain consideration, thereby improving the robustness of the model.
60. Based on user feedback, the staff plan on analysing any specific disclosure requirements relating to the constraint when disclosures are redeliberated by the Boards.

Issue 3: Interaction with the measurement of the transaction price

61. We think that there are two sub-issues raised by constituents with respect to this issue that can be summarised as follows:

    (b) *Sub-issue (a) should the constraint be part of step 3 of the model*: Some respondents questioned why the model in the 2011 ED requires an entity to determine a transaction price at step 3, then allocate that transaction to the performance obligations in step 4, and then determine when the performance obligations are satisfied in step 5 in cases when no revenue will be recognised if the constraint applies.

    (c) *Sub-issue (b) fixed minimum with a variable portion*: Other respondents have questioned how the mechanics of the 2011 ED would work when the transaction price includes both a 'fixed' and 'variable' portion.

Sub-issue (a) – should the constraint be part of step 3 of the model

62. Some respondents highlighted the complexity in applying what they see as a two-step process of:

    (a) first needing to estimate the transaction price in step 3; but

    (b) then needing to determine whether that transaction price can be recognised if the constraint applies in step 5.

63. With respect to this issue, we note that the original reasons why the constraint was modified in the 2011 ED from a transaction price measurement issue (step 3) to be treated as a separate recognition hurdle were:

    (a) there were complications with the application of the onerous test if the constraint was applied to the transaction price; and

    (b) there were unintended revenue recognition patterns for some types of arrangements (as illustrated in Appendix B).

64. Because the Boards tentatively decided to remove the onerous test from the final revenue standard at the July 2012 meeting, the onerous test is no longer a concern

in having the constraint in step 3 of the model. Consequently, there may be merit in moving the constraint back into step 3 because:

(a) the constraint is a measurement issue, so logically it makes more sense to think about it when measuring the transaction price at step 3 of the model; and

(b) it introduces complexity into the model to require an entity to apply all of the other steps in the model, only to prohibit revenue recognition at the end of step 5 when a performance obligation has been satisfied.

65. However, some think that moving the constraint back into step 3 is not preferable because:

(a) the issue of revenue recognition patterns for the arrangements identified in the 2010 ED deliberations would need to be reconsidered;

(b) there is concern that at this stage of the project, there may be other unintended consequences of moving the constraint back into step 3 (for example, illustrative Example 12 from the 2011 ED, the example that deals with reallocation of the transaction price in step 4 of the model, would need to be reconsidered);

(c) the constraint remains viable as a recognition hurdle (part of step 5 in the model). In other words, although the constraint uses measurement as the hurdle for recognition, it is still a *recognition* constraint which is not what step 3 of the model is trying to achieve; and

(d) in practice, preparers may not need to go through steps 1 – 5 for transactions where it is obvious that the constraint applies.

66. In considering this issue, we think that the best alternative would be one that:

(a) addresses the concerns raised by constituents;

(b) does not introduce concerns for arrangements that constituents are comfortable with based on the 2011 ED (in other words create new problems); and

(c) minimises the potential for unintended consequences that might only be identified once the standard is effective.

67. With this in mind, we recommend that the constraint not be moved back into step 3 of the model.

Sub-issue (b) – fixed minimum with variable portion:

68. Based on the guidance in the 2011 ED, an entity would measure its progress towards the satisfaction of the performance obligation using a transaction price that might include both the fixed consideration and an estimate of the variable consideration; however the entity might then be required to constrain the *cumulative* amount of revenue recognised to the fixed consideration. This can result in the amount of revenue recognised hitting a ceiling so that no more revenue can be recognised until the uncertainty is resolved even though the entity continues to perform. For example several respondents interpreted the requirements of the 2011 ED to be as follows:

> An entity agrees to provide a service in exchange for a fixed fee of CU1,200 and a possible contingent bonus of CU800 (which is considered likely to be received, but will not meet the requirements of the constraint until the end of the contract). The entity estimates that the costs to complete the contract will be CU1,000.
>
> The entity estimates the transaction price using the most likely amount, so the transaction price would be CU2,000. When 55% of the work is complete, revenue of CU1,100 and a profit of CU550 are recognised.
>
> After the entity has performed 60% of the work, the constraint will apply as the total unconstrained amount (CU1,200) has been recognised. The entity will recognise further costs, but no corresponding revenue until the end of the contract if the bonus is obtained

69. Paragraphs 81 and 84 of the 2011 ED explain that the constraint applies only to the portion of the transaction price to which the entity is not reasonably assured to be entitled. In other words, the constraint is intended to have a minimum threshold up to which revenue can be recognised. We think that it was not the Boards' intention that the inclusion of a low-end threshold should result in a revenue

recognition pattern as illustrated in the example in the preceding paragraph . Instead, we think that in the example in the preceding paragraph, revenue of CU660 should be recognised when the entity has performed 55% of the work (CU1,200 × 55%).

70. In addition, we think that the concept of a minimum threshold is significant for:

    (a) service contracts that do not specify a "fixed" minimum but in substance the entity is very confident of a minimum amount.

    > For example, an entity agrees to provide a construction service in exchange for a "fully variable" fee. The terms of the contract state that the entity will receive CU1,000,000 if construction is complete in 90 days. For every day that the construction goes beyond 90 days, the customer receives a rebate of CU10,000 and for each day that the construction is completed before 90 days, the customer pays the entity an additional CU10,000.
    >
    > Although the entity is not 'reasonably assured' of the actual amount it will ultimately be entitled to, it is very confident that the amount will not be lower than CU500,000.
    >
    > We think the entity should impute a fixed minimum of CU500,000 for purposes of applying the constraint.

    (b) performance obligations satisfied at a point in time where the entity cannot predict the ultimate consideration that it will be entitled to but is very confident that it will not receive less than a particular amount (this will be considered in more detail in a future Board meeting where the Boards redeliberate the application of the revenue model (and therefore the constraint) for disposals of non-financial assets). Examples of this include provisionally priced contracts subject to true-ups and possibly royalty arrangements if the performance obligation is determined to be satisfied at a point in time.

71. In some transactions where the constraint would apply, we think an entity should split the transaction price into a fixed and variable portion to depict the transfer of goods or services in a more useful manner. The best way to achieve this would be

to require an entity to split the transaction price into a fixed and variable portion when determining if the transaction price is variable in step 3. The fixed portion would not be subject to the constraint, whereas the variable portion would be.

72. If the transaction price is split into a fixed and variable portion, the final standard would need to clarify how an entity would account for changes in the fixed portion of the transaction price; otherwise the issue identified in Appendix B would become relevant again. We think this can be addressed by clarifying that the principles in paragraph 76 of the 2011 ED also apply to partially satisfied performance obligations settled over time (the paragraph that explains how a variable transaction price is allocated to goods and services). In other words, if a variable transaction price allocated to a partially satisfied service has not been recognised due to the constraint, but subsequently is no longer subject to the constraint (for example, because a portion of the transaction price is no longer variable), the entity would allocate that portion entirely to the partially satisfied performance obligation if it was clear that the consideration recognised related to the satisfied performance obligations.

On 1 January, an entity enters into a contract with a customer to provide fund management services for a period of one year. As payment for service, the entity will receive a quarterly fee of 1% of the assets under management (AUM) of the fund at the end of each quarter. The entity determines that the contract contains one performance obligation that is satisfied over time.

The entity estimates the transaction price for the contract to be CU500. The constraint will apply because the promised consideration is variable..

At contract inception, the entity determines that it does not have predictive experience of a minimum amount that it will be entitled to because there is a reasonable chance that one outcome will result in consideration of zero (the AUM represent highly risky investments).

The AUM are CU8,000 at the end of quarter one and consequently the entity is entitled to CU80 at the end of quarter one.

Analysis based on staff proposal

At the end of the first quarter:

> a) the entity has partially satisfied its performance obligation; and
>
> b) CU80 of the transaction price is no longer variable.
>
> The entity determines that the CU80 is allocated entirely to the partly satisfied performance obligation because it is clear that this amount is in exchange for the services performed in the first quarter. Consequently, the entity recognises CU80 of revenue at the end of quarter one.

73. Consequently, we recommend that

    (a) paragraph 84 of the 2011 ED be clarified to explain that the entity should consider splitting the transaction price into a fixed and variable portion if there is an explicit or implicit minimum; and

    (b) the allocation guidance in paragraph 76 of the 2011 ED be expanded to clarify the recognition profile when the explicit or implicit minimum changes.

74. We have included draft wording in Appendix A to this paper to illustrate broadly how the above recommendation might change the wording in the 2011 ED.

Appendix A – bringing it all together

A1. We have tried to illustrate how all of the staff recommendations in this paper might affect the 2011 ED as follows.

Proposals from the 2011 exposure draft	Analysis in this paper	Possible revised text
53. The promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, contingencies, price concessions or other similar items.	Paragraphs 27-33	53. The promised amount of consideration in a contract can vary because of discounts, rebates, refunds, credits, incentives, performance bonuses, penalties, uncertain events, price concessions or other similar items. 53.2 uncertain events described above can be either: i) uncertainties related to price, where an entity has satisfied its performance obligation but the amount to which the entity is entitled varies depending on subsequent events or other variables; or ii) uncertainties related to performance, where the entity's entitlement to consideration is contingent on the occurrence or non-occurrence of uncertain future events.
76. If the transaction price includes an amount of consideration that is contingent on a future event or circumstance (for example, an entity's performance or a specific outcome of the entity's	Paragraphs 68-73	76. If the transaction price includes an amount of consideration that is variable, the entity shall allocate that variable amount (and subsequent changes to the amount) entirely to a distinct good or

performance), the entity shall allocate that contingent amount (and subsequent changes to the amount) entirely to a distinct good or service if both of the following criteria are met: (a) the contingent payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service); and (b) allocating the contingent amount of consideration entirely to the distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract.		service if both of the following criteria are met: (a) the variable payment terms for the distinct good or service relate specifically to the entity's efforts to transfer that good or service (or to a specific outcome from transferring that good or service); and (b) allocating the variable amount of consideration entirely to the distinct good or service is consistent with the allocation principle in paragraph 70 when considering all of the performance obligations and payment terms in the contract. 76.2 Similarly, if a variable transaction price allocated to a partially satisfied service has not been recognised due to the requirements of paragraph 82, but subsequently is no longer subject to the requirements of paragraph 82 (for example, because a portion of the transaction price is no longer variable), the entity shall allocate that portion entirely to the partially satisfied performance obligations if both the criteria in paragraph 76 are met.

A2. Because the staff recommendation relating to Issue 2 (refer to paragraphs 34 – 48 in the paper) was split, we have included below the relevant wording from the 2011 ED, and then illustrated how each of the three options suggested by the staff could potentially impact the relevant paragraphs from the 2011 ED.

<u>Extract from the 2011 Exposure Draft</u>

Constraining the cumulative amount of revenue recognized (see paragraphs IG69–IG71)

81. If the amount of consideration to which an entity expects to be entitled is variable, the cumulative amount of revenue the entity recognizes to date shall not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount of consideration allocated to satisfied performance obligations only if both of the following criteria are met:

(a) The entity has experience with similar types of performance obligations (or has other evidence such as access to the experience of other entities).

(b) The entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations.

82. Indicators that an entity's experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled include, but are not limited to, the following:

(a) The amount of consideration is highly susceptible to factors outside the entity's influence. Those factors include volatility in a market, the judgment of third parties, weather conditions, and a high risk of obsolescence of the promised good or service.

(b) The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.

(c) The entity's experience (or other evidence) with similar types of performance obligations is limited.

(d) The contract has a large number and broad range of possible consideration amounts.

83. An entity shall use judgment and consider all facts and circumstances when evaluating whether the entity's experience is predictive of the amount of consideration to which it will be entitled. The presence of any one of the indicators in paragraph 82 does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.

84. If an entity is not reasonably assured to be entitled to the amount of the transaction price allocated to satisfied performance obligations, the cumulative amount of revenue recognized as of the reporting date is limited to the amount of the transaction price to which the entity is reasonably assured to be entitled.

Option 1 - Qualitative assessment	Option 2 – Determinative approach	Option 3 – Confidence threshold
81. If the transaction price allocated to a performance obligation is variable (as explained in paragraph 53), an entity shall recognise revenue for satisfied performance obligations only when the entity has predictive experience of the amount of consideration to which the entity will ultimately be entitled.		
81. (cont) This assessment is qualitative and takes into consideration both the possibility and significance of the estimated transaction price allocated to the satisfied performance obligation being different to the consideration that the entity will ultimately be entitled to receive. An entity has predictive experience only if both of the following criteria are met… *(remainder of paragraph 81-82 unchanged)*	81. (cont) This assessment is qualitative and takes into consideration both the possibility and significance of the estimated transaction price allocated to the satisfied performance obligation being different to the consideration that the entity will ultimately be entitled to receive. An entity has predictive experience only if both of the following criteria are met ... (*81(a) & 81(b) unchanged)* 82. An entity's experience (or other evidence) is not predictive of the amount of consideration to which the entity will be entitled if: a) there are outcomes that would result in a significantly different amount of consideration from that determined as the transaction price allocated to the satisfied performance obligation; and b) those outcomes have a reasonable possibility of occurring.	81. (cont) An entity has predictive experience only if both of the following criteria are met ... (*81(a) & 81(b) unchanged)* 82. An entity's experience (or other evidence) is predictive of the amount of consideration to which the entity will be entitled if the entity is [highly]* confident that it will be entitled to that portion of the allocated transaction price. Factors that an entity shall consider in determining its level of confidence include, but are not limited to, the following… (*remainder of paragraph 82 indicators unchanged)* ** Highly could be replaced by:*

<table>
<tr><td></td><td></td><td>(a) Reasonably ; or (b) Moderately</td></tr>
<tr><td>83. An entity shall use judgment and consider all facts and circumstances when evaluating whether the entity’s experience is predictive of the amount of consideration to which it will be entitled. The presence of any one of the indicators in paragraph 82 does not necessarily mean that the entity does not have predictive experience of the amount of consideration the entity is entitled to.

An entity shall use assumptions that are consistent with those used to determine the transaction price for the performance obligation. For example, if the entity determined the transaction price based on a portfolio of contracts, the entity shall be consistent when applying the paragraph above.</td><td>83 An entity shall use judgment and consider all facts and circumstances when evaluating whether the entity’s experience is predictive of the amount of consideration to which it will be entitled.

In some cases, an entity will not need to perform a detailed analysis when it is clear from the entity’s experience (or other evidence) that there are reasonably possible outcomes that are significantly different from the transaction price, for example when the amount of consideration is highly susceptible to factors outside of the entity’s influence.

An entity shall use assumptions that are consistent with those used to determine the transaction price for the performance obligation. For example, if the entity determined the transaction price based on a portfolio of contracts, the entity shall be consistent when applying the paragraph above.</td><td>83. An entity shall use judgment and consider all facts and circumstances when evaluating whether the entity’s experience is predictive of the amount of consideration to which it will be entitled. The presence of any one of the indicators in paragraph 82 does not necessarily mean that the entity does not have predictive experience of the amount of consideration the entity is entitled to.

An entity shall use assumptions that are consistent with those used to determine the transaction price for the performance obligation. For example, if the entity determined the transaction price based on a portfolio of contracts, the entity shall be consistent when applying the paragraph above.</td></tr>
<tr><td colspan="3">84. When the entity does not have predictive experience of the ultimate transaction price, the entity instead recognises revenue up to a minimum amount that the entity has predictive experience the transaction price will not be lower than for the satisfied performance obligation, for example because the contract includes a fixed minimum amount. An entity shall update its estimate of the amount of the transaction price that it has predictive experience that it will be entitled to at each reporting period.</td></tr>
</table>

Appendix B – Extract from Agenda paper 10E/140E from March 2011

B1. We have included an extract from agenda paper 10E/140E to illustrate the issue related to the pattern of revenue recognition in the 2010 exposure draft.

11. Some respondents were concerned that the proposed model would constrain the amount allocated to *all* performance obligations in the contract rather than to only the *satisfied or partially satisfied* performance obligation(s) in the contract. Those respondents highlighted the following consequences of constraining the amount allocated to all performance obligations:

    (a) *Unintended effect on the onerous test*: if an entity cannot reasonably estimate the transaction price, the entity would not allocate any consideration to the remaining performance obligations in the contract. Hence, those remaining performance obligations would be deemed onerous even though the entity expects those performance obligations to be profitable.

    (b) *Pattern of revenue recognition that does not depict the entity's performance*: for some contracts, constraining the amount of consideration allocated to all performance obligations would result in a pattern of revenue recognition that does not depict the transfer of goods or services to the customer.

12. The following example illustrates the concerns of respondents:

On 1 January, an entity enters into a contract with a customer to provide fund management services for a period of one year. As payment for services, the entity will receive a quarterly fee 1% of the assets under management (AUM) of the fund at the end of each quarter. The entity determines that the contract contains one performance obligation that is satisfied continuously.

The entity concludes that its experience with similar contracts is not relevant to the contract because the amount of consideration is highly susceptible to external factors (i.e. market risk) and there is a large number of possible consideration amounts.

Under the ED, some have interpreted that revenue would be recognized over the contract period as follows:

	Quarter 1	Quarter 2	Quarter 3	Quarter 4
AUM	8,000	12,000	16,000	16,000
Revenue recognized per quarter (CU)	20	80	170	250
Revenue recognized cumulatively (CU)	20	100	270	520
Revenue calculation by quarter				
Quarter 1	20[(a)]	20	20	20
Quarter 2	0	60[(b)]	30	30
Quarter 3	0	0	120[(c)]	40

Quarter 4	0	0	0	160[d]
Total	20	80	170	250
Calculations: (a) (8,000 x 1%)/4 (b) [(12,000 x 1%)/4 * 2 quarters] (c) [(16,000 x 1%)/4 * 3 quarters] (d) [(16,000 x 1%)/4 * 4 quarters]				

13. Respondents think that recognizing revenue as suggested in the example above would not accurately reflect the asset manager's performance as the service is provided to the customer. Those respondents think that the revenue should be recognized when the consideration for each period is no longer uncertain. Similar concerns were raised by respondents from the hospitality industry with regard to hotel management services.

Appendix C – illustrative examples

C1. We have tried to illustrate how the analysis would be applied for the three options proposed to address paragraphs 82-83 of the 2011 ED.

Example 1 – consumer goods with sales returns (same answer under each option, different approach):

A retailer sells thousands of its core product every month for CU100. The product has been in the market for several years. The entity provides a 60 day no questions asked money back guarantee. The level of sales returns has historically varied between 1% and 4% of total sales per month. The entity estimates that on average, 2% of its sales each month are returned.

The entity has determined the transaction price (step 3) using an expected value because it has determined that this provides a better predictor of the amount of consideration that it will be entitled to for the portfolio of homogenous sales contracts, ie CU98 per sale.

Option 1 – 2011 ED qualitative assessment	*Option 2 – determinative approach*	*Option 3 – confidence approach (assume threshold is set at 70%)*
The transaction price (which has been determined using an expected value method) is predictive of the consideration to which the entity will be entitled to. Although there are factors outside of the entity's influence (ie customer returns), the amount of consideration is not highly susceptible to that factor on a portfolio basis. Consequently, in applying the indicators in paragraph 82 of the 2011 ED, the entity	The transaction price (which has been determined using an expected value method) of $98 compared with the other reasonably possible outcomes based on an expected value approach (of say $99 and $96) are not significantly different. Consequently, the entity has experience with similar performance obligations that is predictive and can recognise CU98 per sale.	Because the entity is at least 70% confident of being entitled to CU98 per sale on a portfolio basis, the entity can recognise the CU98 per sale.

determines that it has predictive experience and therefore can recognise CU98 per sale.		

Example 2 – single contract and performance bonus with a reasonable chance of getting nothing (different outcome depending on the option selected and level of assurance assumed for Option 3):

An entity enters into a contract to construct a specified asset for a fixed fee of CU 5,000 plus a performance bonus for completing construction by a specified date. The entity determines that the contract contains a single performance obligation.

The entity has had experience with similar types of contracts to construct specific assets in the past. At year-end, the entity estimates that there are factors outside of its control (such as weather, employee strikes, supplier delays) but these are less relevant in achieving the performance bonus than factors within its control (such as its estimation error for timing of completion and negotiation of the performance bonus). Based on its previous experience, the entity estimates that there is:

- 30% probability of receiving no bonus
- 40% probability of receiving a bonus of CU1,000
- 20% probability of CU1,500; and
- 10% probability of CU2,000.

The entity has determined the transaction price to be CU6,000 using a most likely outcome approach (CU5,000 fixed plus CU1,000 variable).

Option 1 – 2011 ED qualitative assessment	*Option 2 – determinative approach*	*Option 3 – confidence approach (assume threshold is set at 70%)*
The entity applies the indicators in paragraph 82	The entity's transaction price for the variable	The entity is approximately not less than 70%

<table>
<tr>
<td>when making its determination of whether it has predictive experience for the variable portion of the transaction price (the CU1,000).

There are factors outside of the entity's influence, however the entity determines that these will not significantly affect the variable consideration (para 82(a)). However, the entity still concludes that it does not have predictive experience because there are a broad range of possible outcomes (para 82(d)).

Consequently, the entity is constrained to only recognise the fixed portion of the transaction price.</td>
<td>consideration is CU1,000.

The entity compares both the probability of another outcome occurring as well as the magnitude of the variation if that outcome occurring to determine if it has predictive experience:

<table>
<tr><td>Outcome probability</td><td>difference from transaction price</td></tr>
<tr><td>30%</td><td>-CU1,000</td></tr>
<tr><td>20%</td><td>+CU500</td></tr>
<tr><td>10%</td><td>+CU1,000</td></tr>
</table>
Based on the entities qualitative assessment of the probability and magnitude of the variation, the entity determines that it does not have predictive experience.

Consequently, the entity is constrained to only recognise the fixed portion of the transaction price.</td>
<td>confident of being entitled to CU1,000 because the entity is 70% confident that it will receive at least CU1,000.
Consequently, the entity is constrained to recognise the fixed portion of the transaction price plus CU1,000 of the variable portion.</td>
</tr>
</table>

Example 3 – portfolio of homogenous contracts and performance bonus with a reasonable chance of getting nothing (same answer under each option, different approach): An entity enters into a contract to construct a specified asset for a fixed fee of CU 5,000 plus a performance bonus for completing construction by a specified date. The entity determines that the contract contains a single performance obligation. The entity has had experience with similar types of contracts to construct specific assets and is currently involved in a 100 similar contracts that represent a homogenous portfolio. At year-end, the entity estimates that there are factors outside of its control (such as weather, employee strikes, supplier delays) but these are less relevant in achieving the performance bonus than factors within its control (such as its estimation error for timing of completion and negotiation of the performance bonus). Based on its previous experience, the entity estimates that for each individual contract, there is: - 35% probability of receiving no bonus - 65% probability of receiving a bonus of CU2,000 However, when the entity considers its portfolio of homogenous contracts, it determines that its estimates for the consideration that it will be entitled to from the portfolio of contracts based on its previous experience is as follows: - 95% probability of receiving CU630,000 [(CU1,300 + CU5,000) × 100] - 2.5% probability of receiving a bonus of CU635,000 based on the portfolio - 2.5% probability of receiving a bonus of CU625,000 based on the portfolio Because the entity has a large portfolio of similar contracts, in accordance with paragraph 55 of the 2011 ED, it has determined the transaction price based on the		

<table>
<tr><td colspan="3">portfolio of CU630,000, ie CU6,300 per contract.</td></tr>
<tr><td>Option 1 – 2011 ED qualitative assessment</td><td>Option 2 – determinative approach</td><td>Option 3 – confidence approach (assume threshold is set at 70%)</td></tr>
<tr><td>The entity applies the indicators in paragraph 82 when making its determination of whether it has predictive experience for the variable portion of the transaction price (the CU1,300).

There are factors outside of the entity's influence, however the entity determines that these will not significantly affect the variable consideration (para 82(a)). In addition, there are not a broad range of possible outcomes (para 82(d)) for the portfolio.

Consequently, the entity determines that is has predictive experience and revenue recognition is not constrained.</td><td>The entity's transaction price for the variable consideration is CU1,300.

The entity compares both the probability of another outcome occurring as well as the magnitude of the variation if that outcome occurring to determine if it has predictive experience:

<table><tr><td>Outcome probability</td><td>difference from variable portion of the transaction price</td></tr><tr><td>2.5%</td><td>-CU50 (4%)</td></tr><tr><td>2.5%</td><td>+CU50 (4%)</td></tr></table>
Based on the entities qualitative assessment of the probability and magnitude of the variation, the entity determines that it has predictive experience for the</td><td>The entity is approximately not less than 70% confident of being entitled to CU130,000 because the entity is 70% confident that it will receive the allocated transaction price.
Consequently, revenue recognition is not constrained.</td></tr>
</table>

	portfolio on contracts. Consequently, revenue recognition is not constrained.	

Example 4 – implicit minimum that can be recognised (different outcome depending on the option selected and level of assurance assumed for Option 3):
An entity agrees to provide a construction service in exchange for a "fully variable" fee. The terms of the contract state that the entity will receive CU1,000,000 if construction is complete in 90 days. For every day that the construction goes beyond 90 days, the customer receives a rebate of CU10,000 and for each day that the construction is completed before 90 days, the customer pays the entity an additional CU10,000.

The entity has had experience with similar types of contracts to construct specific assets in the past. At year-end, the entity estimates that there are factors outside of its control (such as weather, employee strikes, supplier delays) but these are less relevant in achieving the construction fee than factors within its control (such as its estimation error for timing of completion and negotiation of the performance bonus). Based on its previous experience, the entity estimates that there is:

- 50% probability of receiving CU1,000,000
- 10% probability of receiving CU1,100,000
- 20% probability of receiving CU 900,000
- 20% probability of receiving CU 750,000

The entity has determined the transaction price to be CU1,000,000 using a most likely outcome approach.

Option 1 – 2011 ED qualitative assessment	*Option 2 – determinative approach*	*Option 3 – confidence approach (assume threshold*

<table>
<tr><td></td><td></td><td>is set at 70%)</td></tr>
<tr>
<td>The entity applies the indicators in paragraph 82 when making its determination of whether it has predictive experience for the variable portion of the transaction price (the CU1,000,000).

There are factors outside of the entity's influence, however the entity determines that these will not significantly affect the variable consideration (para 82(a)). However, the entity still concludes that it does not have predictive experience because there are a broad range of possible outcomes (para 82(d)).

Consequently, the entity is constrained to only recognise the portion of the transaction price it is reasonably assured to be entitled to (para 84).

However, based on the wording in para 84, it is not clear whether this amount would be CU750,000 or CU900,000.</td>
<td>The entity's transaction price for the variable consideration is CU1,000,000.

The entity compares both the probability of another outcome occurring as well as the magnitude of the variation if that outcome occurring to determine if it has predictive experience:

<table>
<tr><td>Outcome probability</td><td>difference from transaction price</td></tr>
<tr><td>10%</td><td>+CU100,000</td></tr>
<tr><td>20%</td><td>-CU100,000</td></tr>
<tr><td>20%</td><td>-CU250,000</td></tr>
</table>
Based on the entities qualitative assessment of the probability and magnitude of the variation, the entity determines that it does not have predictive experience of the transaction price.</td>
<td>The entity is approximately not less than 70% confident of being entitled to at least CU900,000 because the entity is 70% confident that it will receive at least CU900,000.
Consequently, the entity is constrained to recognise only up to CU900,000 until the uncertainty is resolved.</td>
</tr>
</table>

	However, the entity does have predictive experience that there is not a reasonably possible outcome that the amount will be lower than CU750,000. Consequently, the entity treats CU750,000 as a fixed portion which is not subject to the constraint. This assessment is updated at each reporting period.	