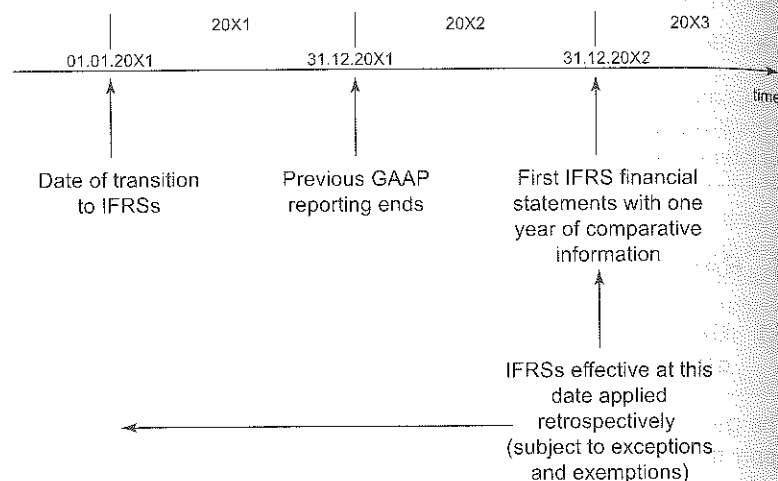


The following timeline summarises these requirements and illustrates key dates for a first-time adopter with a calendar year end that presents comparative information for one year.

IFRS adoption timeline



Subject to the exceptions and exemptions discussed in **sections 6** and **7**, respectively, in its opening IFRS statement of financial position an entity should:

[IFRS 1:10]

- recognise all assets and liabilities whose recognition is required by IFRSs;
- not recognise items as assets or liabilities if IFRSs do not permit such recognition;
- reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different asset, liability or component of equity under IFRSs; and
- apply IFRSs in measuring all recognised assets and liabilities.

5.3 Accounting policies

5.3.1 Selection of accounting policies – general

IFRS 1 requires an entity to use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies must comply with each IFRS effective at the end of its first IFRS reporting period, subject to exceptions and exemptions that are explained in **sections 6** and **7**, respectively. [IFRS 1:7]

The selection of accounting policies under IFRSs is considered in **section 3** of **chapter A5**. A first-time adopter is not bound by the accounting policy choices it made under previous GAAP, even if the previous GAAP treatment is consistent with IFRSs. In particular, in circumstances in which IFRSs permit an explicit choice, that choice is not constrained by the policy adopted under previous GAAP (e.g. whether to use the revaluation basis for a class of property, plant and equipment). However, in other cases (e.g. when there is no specific guidance in IFRSs), the factors that were relevant in selecting an appropriate policy under previous GAAP should be considered when applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

An entity may not apply different versions of IFRSs that were effective at earlier dates. [IFRS 1:8]

5.3.2 Transition provisions in other IFRSs do not generally apply

The transition provisions in other IFRSs apply to changes in accounting policies made by entities that already use IFRSs. They do not apply to a first-time adopter's transition to IFRSs except in certain specified circumstances that are explained in **sections 6** and **7**. [IFRS 1:9]

For example, an entity with a 31 March year end prepares its first IFRS financial statements at 31 March 20X3. It presents a single year of comparative figures. The entity's date of transition to IFRSs is, therefore, 1 April 20X1.

The entity applies all of those IFRSs that are effective for years beginning on 1 April 20X2 (i.e. those that are effective at the end of its reporting period) and ignores any transition provisions in those IFRSs except when IFRS 1 specifies that they should be applied. Those IFRSs should be applied in preparing the opening statement of financial position at 1 April 20X1, the comparative statement of financial position at 31 March 20X2, and the statement of financial position at 31 March 20X3 in accordance with IFRSs. The entity is permitted, but not required, to apply any new IFRSs that have been issued but are not mandatory, provided that the IFRSs in question permit early adoption (see 5.3.3).

5.3.3 Application of new IFRSs that are not yet effective

A first-time adopter may apply a new IFRS that is not yet mandatory if the IFRS permits early adoption. [IFRS 1:8]

Example 7.2.11E**Measurement of an asset acquired in a business combination but not recognised under previous GAAP for which recognition is required under IFRSs**

Company A purchases a licence to operate a business in a particular jurisdiction for CU10 and recognises an intangible asset. Company A is subsequently acquired by Company B. Under its local GAAP, Company B does not recognise the licence as an intangible asset separately from goodwill.

Company B is subsequently acquired by Company C. Company C determines that the fair value of the licence at the date of acquisition of Company B is CU50 and recognises it as an intangible asset separately from goodwill.

Company C is subsequently acquired by Company D, but Company D does not recognise the licence as an intangible asset separately from goodwill.

The licence is therefore reported separately in the individual financial statements of Company A and in the consolidated financial statements of Company C.

Company D subsequently adopts IFRSs and chooses not to restate its acquisition of Company C in accordance with IFRS 3.

At what amount should the licence be recognised upon first-time adoption of IFRSs?

This example is similar to that discussed in **example 7.2.11C**. Although the intangible asset was not recognised in Company D's consolidated financial statements under previous GAAP, the second condition in IFRS 1:C4(b)(ii) is not met and, therefore, the licence should be recognised separately in Company D's consolidated financial statements under IFRSs.

However, this example raises an additional question because there are two alternatives available on which to base the measurement of the intangible asset in Company D's consolidated financial statements (the original cost of CU10 recognised by Company A and the fair value of CU50 recognised by Company C when it acquired Company B). IFRS 1 does not provide guidance as to which of these measures should be used. In many cases, the measurement would be based on the most reliable information. If both measurements were determined to be reliable, then the most recent fair value (CU50) would be the most relevant measurement and should be used. The amount recognised (and the equivalent adjustment to goodwill) will be adjusted for amortisation of the intangible asset in accordance with IFRSs from the date of the measurement to the date of transition to IFRSs.

7.2.12 Adjustments to goodwill**7.2.12.1 Limited circumstances in which goodwill may be adjusted**

As a general principle, under the optional exemption for business combinations, the carrying amount of goodwill in the opening IFRS

statement of financial position is its carrying amount under previous GAAP at the date of transition to IFRSs, adjusted only for the following items:

[[IFRS 1:C4(g)]]

- goodwill is increased when it is necessary to reclassify an item that was recognised as an intangible asset under previous GAAP (see 7.2.8);
- goodwill is decreased (and, if applicable, deferred tax and non-controlling interests adjusted) when it is necessary to recognise an intangible asset that was subsumed within recognised goodwill under previous GAAP (see 7.2.11); and
- regardless of whether there is any indication that goodwill may be impaired, IAS 36 should be applied in testing goodwill for impairment at the date of transition to IFRSs and in recognising any resulting impairment loss in retained earnings (or, if required by IAS 36, in revaluation surplus). The impairment test is based on conditions at the date of transition to IFRSs.

Goodwill should not be subject to amortisation even if it includes a subsumed intangible asset with a finite life. All goodwill should be tested for impairment at the date of transition to IFRSs.

Other adjustments to goodwill are permitted at the date of transition to IFRSs. IFRS 1 highlights the following examples for which goodwill is not adjusted:

[[IFRS 1:C4(h)]]

- to exclude in-process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition under IAS 38 in the separate statement of financial position of the acquiree);
- to adjust previous amortisation of goodwill; or
- to reverse adjustments to goodwill that IFRS 3 would not permit, but that were made under previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to IFRSs.

Although there is no explicit prohibition in IFRS 1 on the reversal of a past impairment of goodwill, this is similar to a reversal of past amortisation which is explicitly prohibited by IFRS 1:C4(h)(ii). Also, the list of permitted adjustments to goodwill under IFRS 1:C4(g) refers only to "any resulting impairment loss" and does not envisage a profit arising from the impairment review of goodwill at the date of transition.

The exemption cannot be applied to other classes of assets by analogy [IFRS 1:D7] The exemption is available regardless of the IFRS accounting policy selected by the entity for ongoing reporting purposes.

IFRS 1:D5 provides the option to measure assets at deemed cost without specifying if the assets have been acquired, self-constructed or held under finance leases. Therefore, the exemption can also be applied to assets held under finance leases and capitalised in the financial statements. A first-time adopter may measure these items at fair value at the date of transition. However, the related finance lease liability is not measured at fair value; rather it is measured at the net present value of the lease payments in accordance with IAS 17 *Leases*.

The exemption in IFRS 1:D5 is not limited to property, plant and equipment within the scope of IAS 16. Consequently, an entity may elect to measure items of property, plant and equipment that are outside the scope of IAS 16 (e.g. certain mineral rights and reserves) at a deemed cost in accordance with IFRS 1:D5 (see also 7.5.4). Whether mineral rights and reserves are property, plant and equipment or intangible assets is considered in section 2 of chapter A7. Property, plant and equipment used in exploration activities are within the scope of IAS 16.

7.5.2.2 Details of the exemption

IFRS 1:D5 permits any asset in the designated categories to be measured at the date of transition to IFRSs at its fair value and that fair value to be used as the asset's deemed cost at that date. When this election is made, the disclosures required by IFRS 1:30 should be made in the entity's first IFRS financial statements (see 9.3.5).

A first-time adopter may also elect to use a previous GAAP revaluation of any asset in the designated categories at, or before, the date of transition to IFRSs as deemed cost at the date of revaluation. This is, however, permitted only if the revaluation was, at the date of the revaluation, broadly comparable to:

[IFRS 1:D6]

- fair value; or
- cost or depreciated cost under IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

The reference to the revaluation being 'broadly comparable' is explained in IFRS 1:BC47 as allowing a first-time adopter "to establish a deemed cost using a measurement that is already available and is a reasonable starting point for a cost-based measurement".

A previous GAAP valuation at a percentage of fair value (e.g. 80%) is not broadly comparable to fair value. IFRS 1:BC47 notes that it may

not always be clear whether a previous revaluation was intended to be a measure of fair value. For the amount to be used as deemed cost, the measurement must represent a valid estimate of fair value. A percentage of fair value is not broadly comparable to fair value and, therefore, cannot be used as the asset's deemed cost.

However, a revaluation in accordance with previous GAAP that results in a carrying amount that is similar to fair value, such as the application of a price index to a previous carrying amount, may be considered broadly comparable.

In accordance with IFRS 1:D6, the previous GAAP revaluation must be "at, or before, the date of transition to IFRSs" and this would exclude a valuation carried out at the end of the last reporting period under previous GAAP. For example, if the end of the first IFRS reporting period is 31 December 20X8 and the date of transition to IFRSs is 1 January 20X7, a valuation carried out at 31 December 20X7 under previous GAAP would not comply with IFRS 1:D6. However, it might be possible instead to use the measurement at 31 December 20X7 under the exemption in IFRS 1:D8(b) (see 7.5.3).

Example 7.5.2.2

Accounting for previously recognised revaluation uplift

Under previous GAAP, Company G measured property, plant and equipment at a revalued amount that was broadly consistent with fair value and accumulated the difference between depreciated cost and the revalued amount within equity. Company G has elected to use the revalued amount as deemed cost under IFRS 1.

How should the revaluation uplift recognised under previous GAAP be accounted for at the date of transition to IFRSs?

IFRS 1:11 requires that the adjustments arising from first-time adoption be recognised in retained earnings or, if appropriate, another category of equity. The Standard does not specifically address the accounting for revaluation uplifts recognised under previous GAAP. The adjustment could be recognised as a separate component of equity but that is not required under IFRS 1.

If a previous GAAP revaluation is used as deemed cost under IFRS 1:D6, any revaluation uplift accumulated in equity under previous GAAP does not form part of the revaluation surplus under IFRSs. Therefore, an impairment loss arising after the transition to IFRSs cannot be offset against the amount accumulated in equity under previous GAAP but instead should be recognised in profit or loss.

4.5.2 Share capital and reserves

4.5.2.1 Presentation when 'legal' share capital is classified as liabilities

IAS 1 requires several disclosures about share capital and reserves. These are described at 4.5.2.4 and 4.5.2.5.

In straightforward cases, these disclosures will be made in respect of the amounts included in the statement of financial position caption 'issued capital and reserves attributable to owners of the parent'. However, this will not always be the case, because amounts that are legally share capital will sometimes be presented, in whole or in part, as liabilities in the statement of financial position in accordance with IAS 32 *Financial Instruments: Presentation*.

There are a number of ways in which the requirements of IAS 1 can be met. For example, it is generally acceptable to present a single line item on the face of the statement of financial position for 'issued share capital and reserves attributable to owners of the parent'. When this approach is taken, the amount presented on the face of the statement of financial position is the 'net' amount (i.e. excluding amounts that are legally share capital but presented as financial liabilities). Further details (e.g. analysing legal share capital between amounts classified as equity and liabilities) can be shown in the notes. This approach may not be appropriate in some jurisdictions; regulatory requirements or general practice may be such that entities present greater detail on the face of the statement of financial position (e.g. share capital, share premium and specified reserves).

When an expanded analysis of equity items is shown on the face of the statement of financial position (either because this is a regulatory requirement or because the entity wishes to present more detail on the face of the statement of financial position), the question arises as to which line items should be reduced by the amounts presented as liabilities.

When the amounts presented as liabilities represent the proceeds of issue of a class (or classes) of shares, the most common approach is that the amounts presented as 'share capital' and 'share premium' on the face of the statement of financial position exclude those amounts (i.e. they relate to equity shares only). Alternatively, the gross amounts for 'share capital' and 'share premium' may be presented on the face of the statement of financial position, with amounts classified as liabilities shown as a separate deduction. In such circumstances, the supplementary disclosures required by IAS 1 regarding share capital (see 4.5.2.4) can be presented separately in the relevant notes for the 'equity' and 'liability' classes of shares. Alternatively, details about all classes of share capital may be presented in a single note, but

distinguishing separately those classes and amounts that have been presented as liabilities.

The position is more complicated when a class of shares (e.g. redeemable convertible preference shares) is accounted for as a compound financial instrument with both equity and liability components. There are several possibilities for presentation in such circumstances, including:

- the share capital and share premium could be shown on the face of the statement of financial position at their 'legal' amounts, with a separate negative reserve equal to the liability recognised; or
- the share capital and share premium could be shown on the face of the statement of financial position as those amounts that relate to equity shares, with a separate line item such as 'equity component of preference shares'; or
- the deduction for the liability might be made first from the share premium and then from share capital; or
- the deduction for the liability might be made from share capital and share premium in proportion to the allocation of the original proceeds of issue between those captions.

All of these are acceptable provided that adequate explanation is provided and that all of IAS 1's disclosure requirements are met. The key point is that the total amount presented as equity is unaffected by these choices.

4.5.2.2 Analysis of reserves

There are some specific instances when IFRSs require a separate component of equity to be maintained. For example, IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires specified exchange differences to be accumulated in a separate component of equity and IAS 16 requires a surplus on revaluation of an asset to be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. Subject to these (and other) specific requirements, there is some flexibility about which items are accounted for as separate components within equity.

See 4.5.2.5 for a discussion of the disclosure requirements regarding reserves within equity.

4.5.2.3 Meaning of 'retained earnings'

When IFRSs require amounts to be accumulated in equity, in the absence of specific requirements in IFRSs (see 4.5.2.2), and subject to local regulatory requirements, it is generally acceptable for these amounts to be included within retained earnings.

of IFRSs. Relevant agenda decisions should be carefully considered as indicative (but not definitive) guidance when selecting a suitable accounting policy for a transaction not specifically addressed by a Standard or an Interpretation.

In the absence of specifically applicable requirements, when an entity is making reference to and considering the applicability of IFRS requirements for similar and/or related issues, the question arises as to whether it is necessary to apply all aspects of the IFRS to the issues being analogised, or whether it could be appropriate to consider only certain aspects of that IFRS. This issue was considered by the IFRS Interpretations Committee in March 2011. The Committee observed that "when management develops an accounting policy through analogy to an IFRS dealing with similar and related matters, it needs to use its judgement in applying all aspects of the IFRS that are applicable to the particular issue".

Therefore, when analogising to the requirements of an IFRS, an entity is not necessarily bound to apply all of the requirements of that IFRS. Rather, the entity should use its judgement in determining which aspects of that IFRS are applicable to the particular issue and then apply all those aspects of the IFRS that it judges to be applicable.

The most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, accounting literature and accepted industry practices may also be considered, provided that they do not conflict with the above sources. [IAS 8:12]

Example 3.1.2

Selection of accounting policy for combinations of entities under common control – requirement to restate comparative information

Entities S1 and S2 are two subsidiaries of holding company H. Following a decision by H to reorganise the legal structure of the group, S1 acquires S2 (i.e. H now holds an indirect interest in S2 in place of the direct interest it held before the reorganisation). The acquisition of S2 by S1 is considered a combination of entities under common control and, under paragraph 2(c) of IFRS 3 *Business Combinations*, is excluded from the scope of that Standard.

This is the first time that S1 has entered into a transaction of this nature and, therefore, it is required to develop a new accounting policy. In the absence of specific IFRS literature on the topic, S1 has applied the requirements of IAS 8:10 to 12 and, in its consolidated financial statements, has chosen to account for the transaction at S2's carrying amounts at the date of the transaction (i.e. as a pooling of interests).

Is S1 obliged to restate the comparative periods in its consolidated financial statements as if S1 had acquired S2 at the beginning of the earliest period presented?

No. Even if S1 has developed its accounting policy by reference to a pronouncement of another standard-setting body that requires restatement of comparatives when the pooling-of-interests method is applied, S1 is not bound to apply all of the requirements of that pronouncement.

However, the decision-usefulness of the restated comparative information should be considered by management when developing its accounting policy and, if the failure to restate comparative information would be detrimental to the users of the financial statements, restatement should be considered. In addition, S1 should consider local regulatory requirements that may require (or prohibit) restatement of comparative periods for such transactions.

3.1.3 Accounting policies to be applied consistently

Accounting policies should be applied consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different policies may be appropriate. If this is the case, an appropriate accounting policy should be selected and applied consistently to each category. [IAS 8:13]

IFRS 10 *Consolidated Financial Statements* requires that consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. [IFRS 10:19] There is no such requirement for the individual or separate financial statements of a parent and its subsidiaries.

In practice, most subsidiaries will choose to apply accounting policies that are applied by their parent because this will simplify the consolidation process. Also, the factors that determine the most appropriate policy for the group will often also determine that the same policy is the most appropriate for the subsidiary.

3.2 Changes in accounting policies

3.2.1 Circumstances in which a change in accounting policy is permitted

An accounting policy can be changed only if the change:

[IAS 8:14]

- is required by an IFRS; or
- results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

It is important that changes in accounting policies are only made if one of the criteria in IAS 8:14 is met; otherwise comparability over time within the financial statements will be lost. [IAS 8:15]

8.9 Changes in valuation techniques

Once a valuation technique has been selected, it should be applied consistently. A change in a valuation technique or its application (e.g. a change in its weighting when multiple valuation techniques are used or a change in an adjustment applied to a valuation technique) is only appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. [IFRS 13:65]

IFRS 13 provides the following examples of events that might appropriately lead to a change in valuation technique:

[IFRS 13:65]

- new markets develop;
- new information becomes available;
- information previously used is no longer available;
- valuation techniques improve; or
- market conditions change.

If a valuation technique does not use unadjusted quoted prices, and in a subsequent period a quoted price in an active market becomes available, the quoted price should be used because IFRS 13:77 states that "a quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available", with limited exceptions.

Depending on the particular circumstances, a change from a valuation technique that uses unadjusted quoted prices to a different valuation technique (such as a discounted cash flow technique) may be appropriate when:

- quoted prices for an identical asset or liability are no longer available; or
- quoted prices are available, but the market is no longer active. Note, however, that prices from relevant observable transactions must be considered in determining fair value even if the market is not active (see 9.5); or
- the entity no longer has access to the market in which the prices are quoted. The entity must be able to access the market in order to use a quote from that market without adjustment to reflect the lack of access, but the entity does not need to be able to sell the particular asset or transfer the particular liability on the measurement date (see section 3.3 for further details); or
- quoted prices are no longer based on relevant observable market data and do not reflect assumptions that market participants would

make in pricing the asset at the measurement date. As discussed at 9.7, an entity cannot necessarily assume that a price provided by an external source is representative of fair value at the measurement date.

A decrease in the volume or level of activity in a market does not necessarily mean that the market is no longer active (see 10.2.1.1 for a discussion of active vs. inactive markets) and, consequently, that a change in the valuation technique is warranted.

In selecting another valuation technique, when appropriate, an entity should maximise the use of relevant observable inputs (e.g. quoted prices for a similar asset or liability with adjustments as appropriate) and minimise the use of unobservable inputs.

If there is a change in the valuation technique used or its application, any resulting difference should be accounted for as a change in accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; however, the disclosures generally required under IAS 8 regarding a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application. [IFRS 13:66]

9 Inputs to valuation techniques

9.1 Definition of inputs

Inputs are defined as "[t]he assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following:

- (a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and
- (b) the risk inherent in the inputs to the valuation technique". [IFRS 13:Appendix A]

Inputs may be observable or unobservable. [IFRS 13:Appendix A] Valuation techniques used to measure fair value are required to maximise the use of relevant observable inputs and minimise the use of unobservable inputs (see section 8). [IFRS 13:67]

Valuation inputs that are observable are more reliable than those that are unobservable (sometimes referred to as 'entity-specific' because these inputs are derived by an entity rather than by the 'market').

6.5 Revaluation of assets by class

6.5.1 Revaluation to be made for entire class of assets

When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs is required to be revalued. [IAS 16:36] Items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and valuations at different dates. [IAS 16:38] This is intended to prevent the distortions caused by the selective use of revaluation, also referred to as 'cherry-picking', so as to take credit for gains without acknowledging falls in the value of similar assets.

6.5.2 Definition of a 'class' of assets

A class of property, plant and equipment is defined as a grouping of assets of a similar nature and use in an entity's operations. [IAS 16:37] The following examples of separate classes are cited:

- land;
- land and buildings;
- machinery;
- ships;
- aircraft;
- motor vehicles;
- furniture and fixtures;
- office equipment; and
- bearer plants.

Bearer plants were added to the examples in IAS 16:37 as part of the June 2014 amendments which brought bearer plants within the scope of IAS 16 (see 2.6).

The examples cited as separate classes are not intended to be prescriptive or comprehensive. In practice, it is not uncommon for some of these classes to be combined. For example, when motor vehicles are not significant to an entity, motor vehicles and machinery may be combined in a plant and machinery class. For similar reasons, office equipment may be included in the furniture and fixtures class.

6.5.3 Disclosure of classes

As discussed in 11.2, detailed disclosures are specified for each class of property, plant and equipment. This should be borne in mind when distinguishing classes, because multiple classes could lead to voluminous disclosures.

6.5.4 Revaluation on a rolling basis

The requirement to revalue entire classes of assets is a potentially onerous requirement because, for some reporting entities, a class of assets could comprise a large number of items. For this reason, IAS 16:38 allows a class of assets to be revalued on a rolling basis, provided that revaluation of the class of assets is completed within a short period of time and that the revaluations are kept up to date.

No further guidance is provided as to how a 'short period' should be interpreted for the purposes of IAS 16:38 although, given the drafting of the Standard, it is presumably less than a financial year. The general approach of IAS 16:38 is, however, to require simultaneous valuations so as to avoid the reporting of amounts that are a mixture of costs and values as at different dates. Accordingly, it would seem appropriate:

- for all such valuations to take place in the same accounting period (and in the same interim period when an entity presents interim financial statements); and
- for the acceptable length of the period to take into account how stable fair values are, so that greater volatility requires a shorter period over which to perform valuations.

6.6 Assets for which fair value cannot be reliably measured

Even when an entity has selected the revaluation model for its property, plant and equipment, only those assets whose fair value can be measured reliably are carried at revalued amounts. [IAS 16:31]

IAS 16 provides no guidance as to the circumstances in which it is appropriate to conclude that the fair value of an item of property, plant and equipment cannot be measured reliably, nor does it address the appropriate accounting for those assets whose fair value cannot be measured reliably.

However, IAS 40 *Investment Property* contains useful guidance on the circumstances in which it is appropriate to conclude that the fair value of an item of property, plant and equipment cannot be measured reliably. Under that Standard, the exception is allowed when, and only when, comparable market transactions are infrequent and alternative

for Government Grants and Disclosure of Government Assistance (see section 5 of chapter A36).

4.7 Exchanges of assets

When an intangible asset is acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of the asset received is measured at fair value (even if the entity cannot immediately derecognise the asset given up), unless either:

[IAS 38:45]

- the exchange transaction lacks commercial substance; or
- the fair value of neither the asset received nor the asset given up is reliably measurable.

In either of these circumstances, which result in the acquired asset not being measured at fair value, its cost is measured at the carrying amount of the asset given up. [IAS 38:45]

Whether or not a transaction has commercial substance is determined by considering the extent to which the entity's future cash flows are expected to change as a result of the transaction. An exchange transaction is considered to have commercial substance if:

[IAS 38:46]

- the configuration (i.e. risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
- the entity-specific value (reflecting post-tax cash flows) of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
- the difference arising in either of the two circumstances outlined is significant relative to the fair value of the assets exchanged.

As set out in 4.2, no intangible asset can be recognised unless its cost can be measured reliably. In an exchange transaction that has commercial substance, if an entity is able to measure reliably the fair value of either the asset received or the asset given up, the fair value of the asset given up should be used to measure cost, unless the fair value of the asset received is more clearly evident. Fair value can be measured reliably if either (1) the variability in the range of reasonable fair value measurements is not significant for that asset, or (2) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. [IAS 38:47]

4.8 Internally generated intangible assets

4.8.1 Additional recognition criteria for internally generated intangible assets – background

Inherently, it is more difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in identifying whether and when there is an identifiable asset that will generate future economic benefits, and in determining the cost of the asset reliably. Therefore, IAS 38 includes additional recognition criteria for internally generated intangible assets which expand on the general recognition criteria. It is assumed that these additional criteria are met implicitly whenever an entity acquires an intangible asset.

Example 4.8.1

Development costs paid to an external party

Company A pays Company B, an external party, to develop an asset that would meet the requirements of IAS 38 for recognition as an internally generated intangible asset in Company A's financial statements (see 4.8.5.1). Company B is performing only development work; all the associated research has already been performed, and the costs expensed, by Company A.

Company A should recognise an internally generated intangible asset for these development costs under IAS 38. Whether Company A incurs the costs directly via an internal development function or outsources the development process to an external party does not influence how Company A should account for the asset in its financial statements.

Therefore, because the expenditure meets the requirements for the recognition of an internally generated intangible asset under IAS 38, Company A should recognise the asset as an internally generated intangible asset in its financial statements. If the asset being developed did not meet the requirements for recognition of an internally generated intangible asset under IAS 38, the costs would be considered research expenditures and would be expensed as incurred. Similarly, if Company B was paid by Company A to perform both research and development activities, the research element would be expensed as incurred, but the development element would be capitalised provided that it met the requirements of IAS 38.

4.8.2 Items that should not be recognised as internally generated intangible assets

The Standard prohibits the recognition of internally generated goodwill as an asset. [IAS 38:48]

Some other internally generated items are specifically identified in IAS 38 as not capable of being distinguished from the cost of developing the business as a whole and therefore are prohibited from being capitalised as internally generated intangible assets. These are internally generated:

the lessee an additional three months to return or to acquire the asset. The extension option must be exercised prior to the end of the main lease term.

Entity X enters into 'residual value guarantee' contracts with Entity A, a third party. Under these contracts, Entity A will purchase the assets from Entity X at the end of each lease term at a predetermined price. Entity A receives a fee in return for providing the residual value guarantee.

When an extension option is exercised by the lessee, ownership of the asset is transferred to Entity A at the end of the main lease term for the predetermined price. During the extension period, Entity X passes the rental income to Entity A. At the end of the extension period, Entity A sells the asset either in the market or to the lessee. Rental income received by Entity A during the extension period is considered incidental to Entity A's principal activities, which are the provision of residual value guarantee contracts and selling the assets acquired.

In order to determine how to recognise the assets in the period from acquisition at the end of the main lease term to the point of sale, Entity A must establish how the assets are used in the business, i.e. whether they represent inventories or property, plant and equipment.

In the circumstances described, Entity A acquires the assets at the end of the main lease term to profit from selling them in the market. In accordance with IAS 2:6, the assets are classified as inventories because they are assets "held for sale in the ordinary course of business".

The assets acquired do not represent property, plant and equipment, in accordance with IAS 16 *Property, Plant and Equipment*, because they are not held primarily for rental by Entity A to others and are not expected to be used during more than one period.

Example 2.1B

Classification and measurement of pipeline fill

Company A operates a pipeline to transport crude oil. Company A does not produce or distribute crude oil; it merely provides the use of its pipeline to the buyer and seller in a contract for a usage fee. The seller and buyer independently negotiate the sales price, and either the buyer or the seller pays a fee to Company A for transporting the oil purchased/sold through its pipeline.

The pipeline needs to be full of oil at all times to be operational. Therefore, during initial construction of the pipeline, Company A purchases oil to fill the pipeline. Once the pipeline is operational, Company A charges a fixed fee for its transportation services and, in effect, swaps crude oil pushed into the pipeline by a seller for crude oil of the same grade and quality delivered to the customer at the exit point of the pipeline. Company A bears the risk of loss due to theft or line loss in excess of the maximums allowed under the contract. Such losses are rare and normally arise as the result of a pipeline spill that is covered by insurance.

The pipeline fill meets the definition of an asset and should be recognised at cost when acquired. The pipeline fill does not meet the definition of property, plant and equipment under paragraph 6 of IAS 16. Rather, it should be classified as inventories in accordance with IAS 2:6 because it is held "in the form of materials or supplies to be consumed in the production process or in the rendering of services".

Because an accounting transaction does not take place at the time of each swap of crude oil, no step-up in the value of inventories is recognised. The pipeline fill is measured at the lower of cost and net realisable value throughout the term of the pipeline's operations in accordance with IAS 2:9.

See **example 9.4.1** in **chapter A14** (or, for entities that have not yet adopted IFRS 15 *Revenue from Contracts with Customers*, **example 6.2.1E** in **appendix A1**) for a discussion of retention of title clauses.

The classification of spare parts, stand-by equipment and servicing equipment as inventories or property, plant and equipment is addressed at 3.2 in **chapter A7**.

IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* addresses the classification of costs relating to production stripping activity in a surface mine as inventories or as a non-current asset – see **section 10** of **chapter A7**.

Supplies purchased during the research phase of a project, for example in the pharmaceutical industry, will not meet the definition of inventories prior to a decision to proceed with commercial production. Nevertheless, such supplies may qualify for recognition as an asset (see **example 4.8.4** in **chapter A9** for further discussion).

2.2 Inventories excluded from the scope of IAS 2

IAS 2 applies to all inventories, except:

[IAS 2:2]

- financial instruments (addressed by IAS 32 *Financial Instruments: Presentation* and either IFRS 9 *Financial Instruments* or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement* – see **Volume B** and **Volume C**, respectively); and
- biological assets related to agricultural activity and agricultural produce at the point of harvest (addressed by IAS 41 *Agriculture* – see **chapter A38**).

For entities that have not yet adopted IFRS 15 *Revenue from Contracts with Customers*, IAS 2:2 also refers to the exclusion from the scope of IAS 2 of work in progress arising under construction contracts,

2.2 Executory contracts

Executory contracts are contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent. [IAS 37:3] Executory contracts do not fall within the scope of IAS 37 unless they are onerous (see 3.9.2).

Examples of executory contracts include:

- employee contracts in respect of continuing employment;
- contracts for future delivery of services such as gas and electricity;
- obligations to pay local authority charges; and
- most purchase orders.

Example 2.2

Executory contract

On 1 January 20X0, Company A enters into a contract with Company B for the manufacture and delivery of 100 units of component Q at five different dates in the future, i.e. 500 units are to be delivered in total. Payment is due on delivery of the units.

On 1 January 20X0, the contract between Company A and Company B is executory because neither party has performed any of its obligations; Company B has not manufactured or delivered any of the units, nor has Company A paid for any of them.

By 1 March 20X0, Company B has produced and delivered 200 of the units and Company A has paid in full for those 200 units. At this date, the contract between Company A and Company B continues to be executory because both parties have partially performed their obligations to an equal extent.

By 1 June 20X0, Company B has produced and delivered the full 500 units, but Company A has only paid for 400 units in total. The contract between Company A and Company B no longer meets the definition of an executory contract because the two parties have not performed under the terms of the contract to an equal extent. Company A is required to recognise a liability for the final 100 units of component Q for which it has not yet paid.

2.3 Provisions, contingent liabilities and contingent assets covered by other Standards

When another Standard deals with a specific type of provision, contingent liability or contingent asset, the more specific Standard should be applied. For example:

[IAS 37:5]

- (a) for entities that have not yet adopted IFRS 15 *Revenue from Contracts with Customers*, provisions relating to construction contracts are dealt with under IAS 11 *Construction Contracts* (see **appendix A2**);
- (b) provisions relating to income taxes are dealt with under IAS 12 *Income Taxes* (see **chapter A13**);
- (c) provisions relating to leases generally fall within the scope of IAS 17 *Leases* (see **chapter A17**). However, because IAS 17 contains no specific requirements to deal with operating leases that have become onerous, IAS 37 applies to such onerous contracts;
- (d) provisions relating to employee benefits are dealt with under IAS 19 *Employee Benefits* (see **chapter A15**);
- (e) provisions relating to insurance contracts are dealt with under IFRS 4 *Insurance Contracts* (see **chapter A39**). However, IAS 37 applies to provisions, contingent liabilities and contingent assets of an insurer other than those arising from its contractual obligations and rights under insurance contracts within the scope of IFRS 4;
- (f) contingent consideration of an acquirer in a business combination is dealt with under IFRS 3 *Business Combinations* (see **section 8.2 of chapter A25**); and
- (g) for entities that have adopted IFRS 15, provisions relating to contracts with customers are dealt with in accordance with that Standard (see **chapter A14**). However, because IFRS 15 contains no specific requirements to deal with contracts with customers that are, or have become, onerous, IAS 37 deals with such onerous contracts.

In addition, the acquirer's treatment of contingent liabilities assumed in a business combination is addressed by IFRS 3 *Business Combinations* (see **chapter A25**).

IAS 37 does apply to provisions for restructurings (including discontinued operations). When a restructuring meets the definition of a discontinued operation, additional disclosures may be required by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* (see **chapter A20**). [IAS 37:9]

IAS 37:5(f) was added in December 2013 by consequential amendments arising from *Annual Improvements to IFRSs: 2010-2012 Cycle*. In May 2014, consequential amendments arising from IFRS 15 *Revenue from Contracts with Customers* deleted the reference to the superseded IAS 11 in IAS 37:5(a) and added IAS 37:5(g).

9.2.2 Assessing the relationship between the contributor and the fund

The contributor is required to assess whether it has control or joint control of, or significant influence, over the fund, in accordance with relevant IFRSs, and to account for its interest by consolidation or the equity method, as appropriate under those Standards. [IFRIC 5:8]

9.2.3 Accounting for the obligation to pay decommissioning costs

The contributor's obligation to pay decommissioning costs should be recognised as a liability, separately from its interest in the fund, unless its contributions to the fund have extinguished its obligation to pay decommissioning costs (even in the event that the fund fails to pay). [IFRIC 5:7] Therefore, when an entity remains liable for expenditure, a provision should be recognised, even when reimbursement is available.

When a contributor has an obligation to make potential additional contributions (e.g. in the event of the bankruptcy of another contributor, or if the value of the investments held by the fund decreases to an extent that they are insufficient to fulfil the fund's reimbursement obligations), this obligation is a contingent liability that is accounted for under IAS 37. The contributor will recognise a liability only if it is probable that additional contributions will be made. [IFRIC 5:10]

9.2.4 Accounting for the contributor's interest in the fund

In the absence of control, joint control or significant influence, the contributor's right to reimbursement from the fund is accounted for in accordance with the rules set out in IAS 37 in respect of reimbursements. [IFRIC 5:9] Therefore, if the reimbursement is virtually certain to be received when the obligation is settled, it should be treated as a separate asset.

The reimbursement should be measured at the lower of the amount of the decommissioning obligation recognised, and the contributor's share of the fair value of the net assets of the fund attributable to contributors. [IFRIC 5:9] Therefore, recognition of an asset in excess of the recognised liability is prohibited. For example, rights to receive reimbursement to meet decommissioning liabilities that have yet to be recognised as a provision are not recognised.

Changes in the carrying amount of the right to receive reimbursement other than contributions to and payments from the fund should be recognised in profit or loss in the period in which those changes occur. [IFRIC 5:9]

9.2.5 Disclosure

Contributors are required to disclose the nature of interests in funds, and any restrictions on access to the assets in the funds. [IFRIC 5:11]

In addition, when the arrangements give rise to contingent liabilities or reimbursement rights that are accounted for under IAS 37, the relevant disclosure requirements of IAS 37 apply.

9.3 IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment

IFRIC 6 addresses the recognition of liabilities for waste management under the European Union's Directive on Waste Electrical and Electronic Equipment (the WE&EE Directive). Specifically, the Interpretation deals with waste from private households arising from products sold on or before 13 August 2005. It does not apply to waste from sources other than private households, nor to household waste arising from products sold after 13 August 2005.

The Interpretation is therefore quite narrow in scope. The general principles in IAS 37 should be applied to determine the appropriate recognition point for other remediation and recycling obligations. However IFRIC 6:7 states that "if, in national legislation, new waste from private households is treated in a similar manner to historical waste from private households, the principles of the Interpretation apply by reference to the hierarchy in paragraphs 10 – 12 of IAS 8". Therefore, before determining an accounting policy for 'new' household waste, entities will need to determine how the WE&EE Directive has been transposed into local law. The Interpretation will also be a source of authoritative guidance on the appropriate accounting for obligations that are imposed by similar cost attribution models.

Under the WE&EE Directive, the obligation to contribute to waste management costs is allocated proportionately to producers of the relevant type of equipment who participate in the market during a specified period (the measurement period). The IFRIC (now the IFRS Interpretations Committee) was asked to determine what constitutes the obligating event for the recognition of a provision for the waste management costs.

The IFRIC decided that the event that triggers liability recognition is participation in the market during a measurement period (and not the production of the equipment, nor the actual incurrence of waste management costs).

9.4 IFRIC 21 Levies

9.4.1 IFRIC 21 – background

IFRIC 21 *Levies* was issued in May 2013 and is effective for annual periods beginning on or after 1 January 2014, with earlier application permitted. IFRIC 21 provides guidance on when to recognise a liability for a levy imposed by a government; it applies both for levies that are

5.2 Eliminations of unrealised intragroup profits

When a group entity sells goods to another group entity, the seller recognises profits made on those sales in its individual financial statements. If those goods are still held in inventories by the purchaser at the end of the reporting period, the profit recognised by the seller, when viewed from the standpoint of the group as a whole, has not yet been earned, and will not be earned until the goods are eventually sold outside the group. On consolidation, the unrealised profit on closing inventories is eliminated from the group's profit, and the closing inventories of the group are recognised at cost to the group. The tax consequences to the seller (both current and deferred, if any), however, are not eliminated. If tax is charged on the results of individual entities, and not on the group, the seller will pay tax on any profits generated from the intragroup sales, even though some of those profits may be unrealised from the group's perspective.

Such consolidation adjustments may have a deferred tax impact in the consolidated financial statements. The intragroup elimination is made as a consolidation adjustment and not in the financial statements of any individual reporting entity. Therefore, the elimination will result in the creation of a temporary difference as far as the group is concerned between the carrying amount of the inventories in the consolidated financial statements and the tax base (assumed to be the carrying amount in the purchaser's individual financial statements). The deferred tax effects arising in respect of this temporary difference should be recognised in accordance with the usual principles.

The tax rate to be used when recognising the deferred tax balance arising from the elimination of unrealised profits on intragroup transactions is determined by reference to the tax jurisdiction where the temporary difference will reverse. This will generally be the tax rate in the purchaser's jurisdiction, because the deduction is available at that rate when the unrealised profit is realised from the sale to an unrelated third party. If the tax rate in the purchaser's jurisdiction differs from that in the seller's, the deferred tax recognised may not equal the tax currently payable by the seller.

Example 5.2

Elimination of intragroup profits in inventories

Company P sells inventories costing CU200 to its overseas subsidiary, Company S, for CU300. Company P's tax rate is 40 per cent, Company S's is 50 per cent. At the end of the reporting period, Company S still holds the inventories.

Company P recognises a current tax liability of CU40 ($\text{CU}100 \times 40\%$) relating to the profit on sale of the inventories but does not recognise any deferred tax balances because there are no future tax consequences from Company P's point of view.

Company S is entitled to a future deduction for the CU300 paid for the inventories and this is therefore the asset's tax base from Company S's perspective. Consequently, in Company S's individual financial statements, the tax base is equal to the carrying amount and no temporary difference arises.

Company P prepares consolidated financial statements and, for financial reporting purposes, gains and losses on intragroup transactions are eliminated on consolidation. Therefore, on consolidation, the carrying amount of the inventories is reduced from CU300 to CU200 (to eliminate the unrealised profit). A CU100 deductible temporary difference arises, representing the difference between the carrying amount (CU200) and the tax base (CU300). A deferred tax asset is calculated by multiplying the temporary difference of CU100 by 50 per cent, because the deduction is available to Company S at that rate when the unrealised profit is realised outside the group on sale of the inventories by Company S. Available evidence supports a conclusion that realisation of the deferred tax asset representing the tax benefit of Company S's deductible temporary differences is probable. The deferred tax asset arising of CU50 is therefore recognised on consolidation.

The impact of this intragroup transaction on Company P's consolidated financial statements is shown below in the following journal entries.

	CU	CU
Dr Current tax expense ($\text{CU}100 \times 40\%$)	40	
Dr Deferred tax asset ($\text{CU}100 \times 50\%$)	50	
Cr Current tax payable		40
Cr Deferred tax benefit		50

To recognise the impact of the intragroup transaction.

In a subsequent period, Company S sells the inventories that it acquired from Company P to an unrelated third party for the same amount that it had previously paid Company P, i.e. CU300. The journal entry to reflect the sales and related tax consequences to be reflected in the consolidated financial statements of Company P is as follows.

	CU	CU
Dr Cash	300	
Dr Cost of goods sold	200	
Dr Income tax expense	50	
Cr Sales		300
Cr Inventories		200
Cr Deferred tax asset		50

To recognise the sales and related tax consequences.

- A **contract liability** is defined as “[a]n entity’s obligation to transfer goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer”.
- A **customer** is defined as “[a] party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration”.
- **Income** is defined as “[i]ncreases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants”.
- A **performance obligation** is defined as “[a] promise in a contract with a customer to transfer to the customer either:
 - (a) a good or service (or a bundle of goods or services) that is distinct; or
 - (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer”.
- **Revenue** is defined as “[i]ncome arising in the course of an entity’s ordinary activities”.
- The **stand-alone selling price** of a good or service is defined as “[t]he price at which an entity would sell a promised good or service separately to a customer”.
- The **transaction price** for a contract with a customer is defined as “[t]he amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties”.

3 General principles and scope

3.1 Objective of IFRS 15

The objective of IFRS 15 is to establish the principles that should be applied by an entity in order to report useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. [IFRS 15:1]

3.2 Core principle of IFRS 15

The core principle of IFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers, reflecting the amount of consideration to which the entity expects to be entitled in exchange for those goods or services. [IFRS 15:2]

When applying IFRS 15, it is important to evaluate the terms of the contract and all relevant facts and circumstances. [IFRS 15:3]

3.3 Consistent application of IFRS 15

IFRS 15 should be applied consistently to contracts with similar characteristics and in similar circumstances. This requirement for consistent application is specifically extended to the use of any practical expedients. [IFRS 15:3]

3.4 Practical expedient – application to a portfolio of contracts (or performance obligations)

Although IFRS 15 specifies the accounting for an individual contract with a customer, the Standard allows as a practical expedient that it can be applied to a portfolio of contracts (or performance obligations) with similar characteristics provided that it is reasonably expected that the effects on the financial statements of applying a portfolio approach will not differ materially from applying IFRS 15 to the individual contracts (or performance obligations) within that portfolio. When accounting for a portfolio, estimates and assumptions that reflect the size and composition of the portfolio should be used. [IFRS 15:4]

Some entities manage a very large number of customer contracts and offer a wide array of product combination options (e.g. entities in the telecommunications industry may offer a wide selection of handsets and wireless usage plan options). For these entities, it would take significant effort to apply some of the requirements of IFRS 15 (e.g. the requirement to allocate the stand-alone selling price to the identified performance obligations as described in section 8) on an individual contract basis. In addition, the capability of information technology systems to capture the relevant information may be limited.

Entities will need to evaluate whether they are eligible to use a portfolio approach under IFRS 15:4. IFRS 15 does not provide explicit guidance on how to (1) evaluate ‘similar characteristics’, and (2) establish a reasonable expectation that the effects of applying a portfolio approach would not differ materially from those of applying the Standard at a contract or performance obligation level. Accordingly, entities will need to exercise significant judgement in determining that the contracts or performance obligations that they have segregated into portfolios have similar characteristics at a sufficiently granular level to ensure that the outcome of using a particular portfolio approach can reasonably be expected not to differ materially from the results of applying the Standard to each contract or performance obligation in the portfolio individually.

In segregating contracts (or performance obligations) with similar characteristics into portfolios, entities should apply objective criteria associated with the particular contracts or performance obligations and their accounting consequences. When determining whether particular contracts have similar characteristics, entities may find it helpful to focus particularly on those characteristics that have the most significant

that). In such a scenario, the seller might conclude that only 30 per cent of the variable consideration should be included, because inclusion of a higher amount might result in a significant revenue reversal. In that case, the amount of revenue recognised would be restricted to the following:

$$(CU100 \times 30\%) + (CU90 \times 70\%) = CU93$$

7.2.5 Reassessment of variable consideration

The estimated transaction price is updated at the end of each reporting period (including updating the assessment of whether an estimate of variable consideration should be constrained – see 7.3) to represent the circumstances present at the end of the reporting period and any changes in circumstances during the reporting period. IFRS 15 specifies how changes in the estimated transaction price should be recognised (see 8.5). [IFRS 15:59]

7.3 Constraining estimates of variable consideration

IFRS 15 includes separate requirements in relation to the recognition of revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property. These are discussed at 11.2.

For all other types of variable consideration, variable consideration should only be included in the transaction price to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. [IFRS 15:56]

The term 'highly probable' is intended here to mean that 'the future event or events are likely to occur'. [IFRS 15:BC211]

An entity should consider both the likelihood and the magnitude of the revenue reversal when assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved. Factors that may increase the likelihood or the magnitude of a revenue reversal include the following:

[IFRS 15:57]

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. For example volatility in a market, the judgement or actions of third parties, weather conditions or 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 experience (or other evidence) that the entity has with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value;
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances; and
- (e) there are a large number and broad range of possible consideration amounts within the contract.

Example 7.3A

Price concessions

[IFRS 15:IE116 - IE123, Example 23]

An entity enters into a contract with a customer, a distributor, on 1 December 20X7. The entity transfers 1,000 products at contract inception for a price stated in the contract of CU100 per product (total consideration is CU100,000). Payment from the customer is due when the customer sells the products to the end customers. The entity's customer generally sells the products within 90 days of obtaining them. Control of the products transfers to the customer on 1 December 20X7.

On the basis of its past practices and to maintain its relationship with the customer, the entity anticipates granting a price concession to its customer because this will enable the customer to discount the product and thereby move the product through the distribution chain. Consequently, the consideration in the contract is variable.

Case A – Estimate of variable consideration is not constrained

The entity has significant experience selling this and similar products. The observable data indicate that historically the entity grants a price concession of approximately 20 per cent of the sales price for these products. Current market information suggests that a 20 per cent reduction in price will be sufficient to move the products through the distribution chain. The entity has not granted a price concession significantly greater than 20 per cent in many years.

To estimate the variable consideration to which the entity will be entitled, the entity decides to use the expected value method (see [IFRS 15:53(a)]) because it is the method that the entity expects to better predict the amount of consideration to which it will be entitled. Using the expected value method, the entity estimates the transaction price to be CU80,000 (CU80 × 1,000 products).

The entity also considers the requirements in [IFRS 15:56 to 58] on constraining estimates of variable consideration to determine whether the estimated amount of variable consideration of CU80,000 can be included in the transaction price. The entity considers the factors in [IFRS 15:57] and determines that it has significant previous experience with this product and current market information that supports its estimate. In addition, despite some uncertainty resulting from factors outside its influence, based on its current market estimates, the entity expects the price to be resolved within a short time frame. Thus, the entity concludes that it is highly probable that a significant reversal in the cumulative

to continue to perform as required under the contract (ie pay the promised consideration) are enforceable.

9.2.4.4 Real estate sales – example

Example 9.2.4.4

Real estate sales before completion by a property developer

Entity A, a real estate developer, entered into sales and purchase agreements with various buyers before the completion of a property project. The properties are located in Country B. The sales and purchase agreements include the following key terms:

- a specific unit is identified in the contract;
- Entity A is required to complete the property in all respects in compliance with the conditions set out in the sales agreement and the related building plans within two years from the time when the sales contracts are entered into;
- the property remains at Entity A's risk until delivery;
- the buyer is not permitted at any time before delivery to sub-sell the property or transfer the benefit of the agreement. However, the buyer can at any time before the date of assignment mortgage the property in order to finance the acquisition of the property;
- the sales agreement can be cancelled only when both the buyer and Entity A agree to do so – in effect, the buyer does not have the right to cancel the sales agreement. If both the buyer and Entity A agree to cancel the contract, Entity A has the right to retain 10 per cent of the total purchase price, and the buyer is required to pay for all necessary legal and transaction costs incurred by Entity A in relation to the cancellation;
- if Entity A fails to complete the development of the property within the specified two-year period, the buyer has the right to rescind the sales contract and Entity A is required to repay to the buyer all amounts paid by the buyer together with interest. Otherwise, the buyer does not have a right to cancel the contract; and
- the purchase consideration is payable as follows:
 - 5 per cent of the purchase consideration upon entering into the sales agreement;
 - 5 per cent of the purchase consideration within one month from the date when the sales agreement is entered into;
 - 5 per cent of the purchase consideration within three months from the date when the sales agreement is entered into; and
 - the remaining 85 per cent of the purchase consideration upon delivery of the property.

Note that, for simplicity, this example does not consider whether there is a significant financing element.

Should Entity A recognise revenue over time or at a point in time?

Under IFRS 15, an entity satisfies a performance obligation over time when it transfers control of the promised good or service over time. IFRS 15:35 states that an entity transfers control of a good or service over time and, consequently, satisfies a performance obligation and recognises revenue over time if one of the following criteria is met:

- (a) the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs;
- (b) the entity's performance creates or enhances an asset (e.g. work in progress) that the customer controls as the asset is created or enhanced; or
- (c) the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Criterion IFRS 15:35(a) is not relevant in determining whether revenue from real estate sales (before completion) should be recognised over time or at a point in time. This is because buyers generally do not consume all of the benefits of the property as the real estate developers construct the property; rather, those benefits are consumed in the future.

Criterion IFRS 15:35(b) is not directly relevant in the circumstances under consideration because, without further consideration of criterion 15:35(c), a conclusion cannot be reached about whether the buyers have control of the property as Entity A develops the property.

Entity A should focus on criterion IFRS 15:35(c), and in particular:

- whether an asset has been created with an alternative use to the real estate developer; and
- whether the real estate developer has an enforceable right to payment for performance completed to date.

Has an asset been created with an alternative use to Entity A?

In accordance with IFRS 15:36, an asset does not have an alternative use to an entity if the entity is either restricted contractually from readily directing the asset for another use during the creation or enhancement of that asset, or is limited practically from readily directing the asset in its completed state for another use.

With regard to contract restriction, IFRS 15:B6 states that the entity does not consider the possibility of a contract termination in assessing whether the entity is able to direct the asset to another customer.

Because, in the circumstances under consideration, each sales contract specifies the unit to be delivered, the property unit does not have an alternative use to Entity A. The contract precludes Entity A from transferring the specified unit to another buyer.

In addition to the initial costs to set up the technology platform, the entity also assigns two employees who are primarily responsible for providing the service to the customer. Although the costs for these two employees are incurred as part of providing the service to the customer, the entity concludes that the costs do not generate or enhance resources of the entity (see [IFRS 15:95(b)]). Therefore, the costs do not meet the criteria in [IFRS 15:95] and cannot be recognised as an asset using IFRS 15. In accordance with [IFRS 15:98], the entity recognises the payroll expense for these two employees when incurred.

12.4 Amortisation and impairment of contract costs

12.4.1 Amortisation of capitalised contract costs

An asset recognised in respect of a cost of obtaining or fulfilling a contract should be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under a specific anticipated contract (as described in IFRS 15:95(a) – see 12.3). [IFRS 15:99]

IFRS 15 does not provide specific guidance on the method an entity should use to amortise these assets. Amortisation of capitalised costs on a 'systematic basis' should take into account the expected timing of transfer of the goods and services related to the asset (which typically corresponds to the period and pattern in which revenue will be recognised in the financial statements). The pattern in which the related revenue is recognised could be significantly front-loaded, back-loaded or seasonal, and costs should be amortised accordingly.

To determine the pattern of transfer, entities may need to analyse the specific terms of each arrangement. In determining the appropriate amortisation method, they should consider all relevant factors including:

- experience with, and ability to reasonably estimate, the pattern of transfer; and
- the timing of the transfer of control of the goods or services to the customer.

In some situations, more than one amortisation method may be acceptable if this reasonably approximates the expected period and pattern of transfer of goods and services. However, an amortisation method is unacceptable if it is not expected to reflect the period and pattern of such transfer. When entities select a method, they should apply it consistently to similar contracts. If there is no evidence to suggest that a specific pattern of transfer can be expected, a straight-line amortisation method may be appropriate.

If the pattern in which contractual goods or services are transferred over the contract term varies significantly each period, it may be appropriate to use an amortisation model that more closely aligns with the variations in the transfer pattern. For example, amortisation could be allocated to the periods on the basis of the proportion of the total goods or services transferred each period. If the cost is related to goods or services transferred at a point in time, it follows that the amortised cost should be recognised at the same point in time.

When the contractual goods or services are transferred over an uncertain duration, entities should consider whether the relationship with the customer is expected to extend beyond the initial term of "a specific anticipated contract" (as referred to in IFRS 15:99 and described in IFRS 15:95(a)). For example, if an entity enters into a four-year contract with a customer but the customer relationship is expected to continue for six years, the appropriate amortisation period may be six years (i.e. the expected duration of the relationship).

When an entity's customer has been granted a material right to acquire future goods or services, and revenue related to the material right is being deferred, an entity should consider whether it would be appropriate to allocate to that right a portion of the costs that are capitalised in accordance with IFRS 15:91 or IFRS 15:95.

In situations in which the customer has been granted a material right to acquire future goods or services, and some revenue is being deferred in respect of that right, it would typically be reasonable also to regard a proportion of the costs capitalised in accordance with IFRS 15:91 or 95 as relating to that right. The amortisation is updated to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Any change is accounted for as a change in accounting estimate in accordance with IAS 8 (see **chapter A5**). [IFRS 15:100]

12.4.2 Impairment of contract costs

An impairment loss is recognised in profit or loss to the extent that the carrying amount of an asset recognised in respect of a cost of obtaining or fulfilling a contract exceeds:

[IFRS 15:101]

- (a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less
- (b) the costs that relate directly to providing those goods or services (see 12.3) and that have not been recognised as expenses.