Think Ahead ACCA

Technical factsheet

Revenue recognition under FRS 102 (September 2024)

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Introduction

On 27 March 2024, the Financial Reporting Council (FRC) issued its final amendments to UK and Ireland accounting standards arising from its periodic review. The periodic review amendments become effective for accounting periods commencing on or after 1 January 2026, with early adoption permissible provided all the periodic review amendments are applied at the same time.

In September 2024, the FRC also issued new editions of UK and Ireland GAAP, which incorporate the periodic review amendments.

ACCA comment
Where an entity has chosen not to early adopt the periodic review amendments, the provisions in FRS 102 (January 2022) or FRS 105 (January 2022) continue to apply until accounting periods commencing on or after 1 January 2026. FRS 102 (September 2024) also contains specific disclosure requirements in the statement of cash flows in respect of supplier finance arrangements. These additional disclosures become mandatorily effective for accounting periods commencing on or after 1 January 2025, although early adoption is permissible.

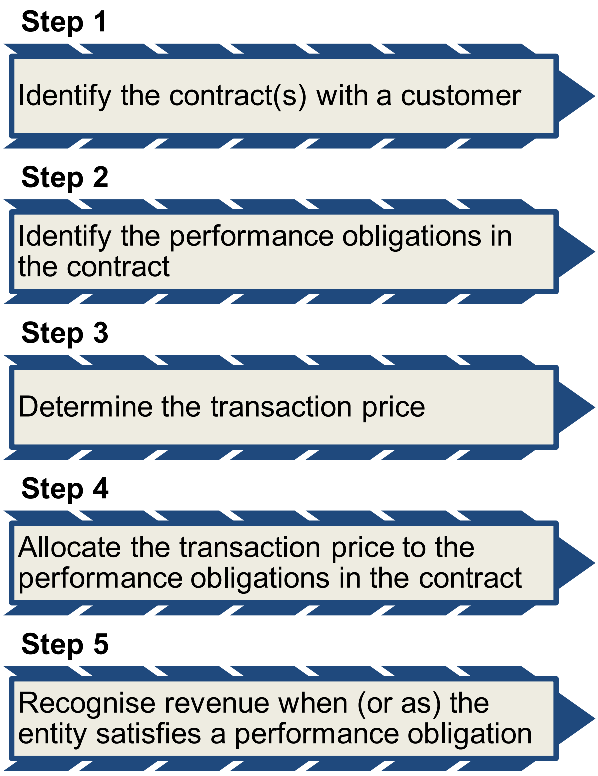
One of the headline changes from the periodic review is in relation to revenue recognition, which is the focus of this factsheet. The other headline change was in respect of lease accounting. ACCA has published a factsheet on the new lease accounting treatments.

The new revenue recognition treatments apply to entities applying FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland* and to micro-entities applying FRS 105, *The Financial Reporting Standard applicable to the Micro-entities Regime.*

New principles for revenue recognition

Within both FRS 102 (September 2024), section 23, *Revenue from Contracts with Customers* and FRS 105 (September 2024), section 18, *Revenue from Contracts with Customers*, is a five-step comprehensive model for recognising revenue. FRS 102 para 23.4 clarifies that the objective of the model is for an entity to recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and/or services.

The five-step model approach works as follows:



A similar model is incorporated in FRS 105, section 18 although section 18 contains additional simplifications due to the target audience of FRS 105.

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

FRS 102, para 23.7 set out specific criteria (all of which **must** be met), in accounting for a contract with a customer. These criteria are as follows:

(a) The parties to the contract have approved the contract and are committed to perform their respective obligations.

(b) The entity can identify each party’s rights regarding the goods or services to be transferred.

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

(d) The contract has commercial substance.

(e) It is probable (ie more likely than not) that the customer will have the ability and intention to pay the consideration to which the entity is entitled when it becomes due.

ACCA comment

A business transaction is said to have 'commercial substance' when it is expected that the future cash flows of the entity will change as a result of the transaction. If it does not, the transaction lacks commercial substance and will generally not be a valid transaction.

Example

The principal activity of Salinger Ltd is that of an IT services provider. One of its many services is providing support and repair services via the internet and onsite to both corporate customers and the general public.

Salinger Ltd enters into a contract with a new customer to scan its server for viruses and to clean up redundant files. An IT consultant has agreed a price with the customer by telephone. As the customer is new, and does not have credit facilities, the IT consultant took payment for the work over the telephone.

The services will be carried out by Salinger Ltd in the next week once the customer's premises are closed (to avoid any disruption during working hours). Salinger will be able to login to the customer's server and carry out the necessary work.

Salinger Ltd and its customer have entered into an oral contract. A contract need not be in writing for it to be enforceable (the three elements to a contract are 'offer', 'acceptance' and 'consideration', all of which have been provided). The customer has provided payment details and consideration for the services to be provided, hence Salinger is committed to performing the work on the customer's server.

In this situation, all the criteria in FRS 102, para 23.7 are met and the contract is within scope of FRS 102, section 23.

Step 2: Identify the performance obligations in the contract

FRS 102 defines a 'performance obligation' as:

*'A promise in a **contract** with a **customer** to transfer to the customer either:*

(a) a distinct good or service (or a distinct bundle of goods or services); 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.'

Some contracts contain more than one performance obligation. For example, a client could sell an item of machinery to a customer and provide one year's servicing and maintenance. Similarly, a course provider might enter into a contract to provide five lectures at various different times and a textbook either on the first day of the course, or on receipt of payment or initial registration.

Example
Harper Ltd is a bookkeeping software developer. It enters into a three-year contract with its customer to provide a licence to access the bookkeeping software. The contract stipulates that Harper will provide periodic software updates and technical support throughout the duration of the contract. The bookkeeping software is delivered electronically prior to installation, updates and technical support, and is functional without the updates and/or technical support. This means that the customer benefits from each good or service individually. Harper has also determined that the licence, installation, updates and technical support are all separately identifiable. Hence, in this scenario there are four performance obligations in the one contract: • the licence to supply bookkeeping software • the installation service • updates to the software • technical support.

Step 3: Determine the transaction price

There are various sub-components in determining the transaction price and FRS 102, paras 23.43 to 23.64 cover the following issues:

Issue	**FRS 102 paragraph(s)**
Variable consideration	23.43 to 23.47
Sales-based or usage-based royalties	23.48
Refund liabilities	23.49 to 23.50
Sale with a right of return	23.51 to 23.57
Time value of money	23.58 to 23.60
Non-cash consideration	23.61
Consideration payable to a customer	23.62 to 23.61

Variable consideration

When a contract with a customer includes variable consideration, an entity must estimate the amount it will be entitled to. There are two possible methods, shown in the table below, and the most appropriate method will depend on which one better predicts the amount of consideration the entity will be entitled to:

The expected value	**The most likely amount**
This is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.	This is the single most likely amount in a range of possible consideration amounts (in other words, the most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (such as whether an entity receives a performance bonus or not).

FRS 102, para 23.46 states that an entity must include in the transaction price an amount of variable consideration **but only** to the extent that it is *highly probable* that it will be entitled to the cumulative amount of revenue recognised when the uncertainty associated with the variable consideration is subsequently resolved.

ACCA comment
The term 'highly probable' is defined as: *'Significantly more likely than **probable**.'* The term 'probable' is defined as 'more likely than not'. In our view, this is a high hurdle and one that will need convincing evidence that the entity is entitled to the cumulative amount of revenue.

For example, if a product is sold with a right to return then the consideration is variable. The entity estimates the variable consideration and must establish whether, or not, to include it in the transaction price. Any refund liability is equivalent to the consideration received or receivable that the entity does not expect to be entitled to.

Sales-based or usage-based royalties

The issue to note where sales-based or usage-based royalties are concerned is that the entity does not apply the variable consideration provisions in FRS 102 where the entity obtains a licence of intellectual property when that licence is the sole or predominant item to which the royalty relates. Instead, the entity recognises revenue for such royalties when (or as) the **later** of the following events occurs:

(a) the subsequent sale or usage takes place

(b) the performance obligation to which some or all of the sales-based or usage-based royalty has been allocated has been satisfied (or partially satisfied).

ACCA comment
The exception to the general principles of accounting for variable consideration only applies to licences of intellectual property and cannot be applied to other transactions by analogy. An entity that sells, as opposed to licenses, intellectual property will not be able to apply the sales-based or usage-based royalty exception. Where an entity enters into sales-based or usage-based royalty arrangements in transactions other than licences of intellectual property, then variable consideration is included in the transaction price and recognised when the related performance obligations are satisfied. In addition, the 'later of' time condition for royalties is intended to prevent royalty revenue being recognised prior to the entity satisfying a performance obligation. This is a tricky area, and one that will invariably require management to apply judgement in determining whether recognising royalty revenue due might result in an acceleration of revenue ahead of performance for a right to access intellectual property.

Refund liabilities

FRS 102, para 23.49 requires a refund liability to be recognised if the entity receives consideration from a customer and expects to refund some, or all, of that consideration.

Any refund liability is measured at the amount of consideration received (or receivable) to which the entity does not expect to be entitled – in other words, amounts that are **not** included in the transaction price. The entity must update the estimate of the refund liability at each reporting date to reflect any relevant change in circumstances.

Sale with a right of return

Generally, customers are entitled by law to return goods that are either faulty, not as described or unfit for purpose. In addition, customers can also return goods that are in perfect working order, provided that they do so within a specified return period.

FRS 102, paras 23.51 to 23.57 deal with sales with a right to return. It should be emphasised that FRS 102, para 23.52 confirms that exchanges by customers of one product for another of the same type, quality, condition and price are not considered returns for the purposes of these paragraphs.

Instead of recognising revenue for these expected returns, the entity must recognise a refund liability and use the rules relating to variable consideration (FRS 102, paras 23.41 to 23.47). The cost of the inventory expected to be returned is also excluded from cost of sales and instead remains in inventory (adjusted for any potential impairment or restock costs).

The refund asset that remains in inventory is initially measured at the former carrying amount of the stock, less:

- any expected costs to recover those products
- allowances for potential decreases in the value to the entity of those products.

Time value of money

Where payment is deferred beyond normal business terms or is financed by the entity at a rate of interest that is not market rate, the arrangement constitutes a financing arrangement and hence the provisions in FRS 102, para 11.13 or 12.7 will apply.

An entity adjusts the amount of expected consideration for the effects of the time value of money, and, as the discount unwinds, it is recognised as interest income in accordance with FRS 102, section 11, *Basic Financial Instruments* or section 12, *Other Financial Instruments Issues*.

ACCA comment
It should be noted that FRS 102, para 23.58 requires the entity to present interest revenue separately from revenue from contracts with customers.

Reporting entities need not adjust the amount of consideration for the effect of the time value of money where the customer is expected to pay for those goods/services within 12 months or less.

Non-cash consideration

Any non-cash consideration is measured at fair value. Where the entity is unable to reliably estimate the fair value of non-cash consideration reliably, the transaction is measured using the stand-alone selling price of the good or service promised to the customer.

Example: non-cash consideration

Bolton Ltd sold goods to Wanderers Ltd on 10 April 2024. The consideration received by Bolton was 1,000 shares in Wanderers Ltd at a fair value of £5 each. At Bolton's reporting date (31 December 2024), the shares in Wanderers had increased to £6 per share.

This contract contains a single performance obligation, and the consideration is non-cash. Non-cash consideration is measured at fair value.

Revenue is recognised at £5,000 (1,000 shares x £5 each). The subsequent increase in the share price of Wanderers Ltd is not recognised as revenue but is accounted for in accordance with FRS 102, section 11 or section 12.

Consideration payable to a customer

Consideration payable to a customer is recorded as a reduction of revenue. The exception to this rule is where the payment is in exchange for a distinct good or service that the customer transfers to the entity, in which case it is recorded as a purchase transaction.

Assuming that the consideration paid to a customer is not in exchange for a distinct good or service, the entity recognises the reduction in revenue when (or as) the later of either of the following events takes place:

(a) The entity recognises revenue for the transfer of the related goods or services to the customer.
(b) The entity pays, or promises to pay, the consideration (even if the payment is conditional on a future event).

Example: consideration paid to a customer

Philbin Partitions & Wall works Ltd (Philbin) enters into a contract with Ratchford's Retailers (Ratchford). Ratchford agrees to buy £325,000 worth of goods over the next 12 months for use in its retail stores across the UK. The terms stipulate that Philbin provides compensation of £19,500 to Ratchford for changes it will need to make to its retail units.

At Philbin's year end 31 March 2024, it had transferred products with a sales value of £31,250 to Ratchford.

In this scenario, the payment made by Philbin to Ratchford is not in exchange for a distinct good or service. Hence, the £19,500 payment is treated as a reduction of the transaction price (ie revenue).

The total transaction price is being reduced by 6% (£19,500/£325,000). Philbin reduces the price allocated to each product supplied by 6% as it is transferred.

At the year end 31 March 2024, Philbin should have recognised revenue of £29,375 (£31,250 x 94%).

As you can see, there are many elements that must be considered by the entity when determining the transaction price (ie applying step 3 of the five-step model). In most cases, professional judgement will be needed and auditors, in particular, will need to pay careful attention to the determination of the transaction price.

Example: determining the transaction price
Lenny Industries Ltd enters into 30 contracts with its customers to supply various chemical products. Each contract includes the sale of one type of chemical with a selling price of £1,200. (VAT issues are ignored for the purposes of this example.) The cost to Lenny Industries of each of these types of chemicals is £700. Customers can return the products within 30 days for a full credit and any returned goods can be used in other chemical mixes or sold again at a profit. The finance director can reliably estimate the return rate for this type of chemical based on previous experience. On this basis, the finance director has estimated that 26 products will not be returned, meaning that four are expected to be returned. As customers can return the products, the consideration is variable. FRS 102, para 23.44 requires any of the following methods to be used when estimating variable consideration: (a) the expected value method (b) the most likely amount method. Using the expected value method, the estimated variable consideration is £31,200 (26 products x £1,200). The variable consideration is included in the transaction price because, based on past experience, it is highly probable that Lenny Industries will be entitled to the cumulative amount of revenue recognised (£31,200) when the uncertainty associated with the variable consideration is subsequently resolved per FRS 102, para 23.46. Revenue of £31,200 and a refund liability of £4,800 (4 products expected to be returned x £1,200) is recognised per FRS 102, paras 23.53(a) and (b). In addition, Lenny Industries will derecognise the inventory transferred to its customers. It will also recognise a refund asset (classified as inventory) of £2,800 (4 products x £700 cost) as well as a corresponding credit to cost of sales. This represents the entity's right to recover products from customers on settling the refund liability per FRS 102, para 23.53(c).

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

FRS 102, para 23.65 requires the entity to allocate the transaction price to each performance obligation identified on a relative stand-alone selling price basis, unless allocating discounts or variable amounts on an alternative basis.

Where a customer is offered a discount for purchasing a bundle of goods and services, the discount is allocated across all performance obligations within the contract in proportion to their stand-alone selling prices, unless observable evidence suggests that this would be inaccurate.

Example: allocating the transaction price

Sunnie Industries Ltd sells an industrial cutting machine with one year's free technical support for £100,000. The sale of the machine and the technical support have both been identified as separate performance obligations.

On a stand-alone basis, the machine would sell for £95,000. This is the first time Sunnie has started to provide technical support for this type of machine. Other support services provided by Sunnie (all of which generate a profit), attract a markup of 50%. It is expected that the technical support service will cost £20,000.

The selling price of the machine on a stand-alone basis is £95,000 but there is no observable selling price for the provision of technical support. FRS 102, para 23.69 requires the stand-alone selling price to be estimated. FRS 102, para 23.70 suggests the following suitable methods:

(a) an adjusted market assessment approach
(b) expected cost plus a margin approach
(c) residual approach.

The residual approach would attribute £5,000 (£100,000 - £95,000) to the technical support service. This does not, however, approximate the stand-alone selling price of similar technical support services, which generate a profit for the entity.

A more appropriate approach would be an expected cost plus a margin approach. Based on this approach, the selling price of the technical support service would be £30,000 (£20,000 x 150%).

The total of the stand-alone selling prices of the machine and technical support is £125,000 (£95,000 + £30,000). However, the total consideration is only £100,000. This means the customer is receiving a discount for purchasing a bundle of goods and services of 20% (£25,000/£125,000).

FRS 102, para 23.74 assumes that discounts relate to all performance obligations within a contract unless this basis does not depict the amount of consideration to which the entity expects to be entitled (in which case the entity uses a method that does reflect such amounts).

The transaction price allocated to the machine is £76,000 (£95,000 x 80%).

The transaction price allocated to the technical support is £24,000 (£30,000 x 80%).

Changes in the transaction price

Changes in the transaction price might arise, for example, because the entity updates its estimate of variable consideration due to a change in circumstances.

When a change in transaction price arises, the entity must allocate the change to performance obligations in the contract on the same basis as at the start of the contract. This means that the entity does not reallocate the transaction price to reflect changes in stand-alone selling prices post-contract inception. Amounts allocated to a performance obligation that have already been satisfied are recognised as revenue, or as a reduction of revenue, in the period in which the estimate of the transaction price changes.

A change in transaction price arising from a **contract modification** is accounted for in accordance with FRS 102, paras 23.13 to 23.16, but in applying FRS 102, para 23.76, the entity must take account of the following:

(a) If the modification is accounted for as a termination of the existing contract and the creation of a new contract, the entity allocates the change in the transaction price to the performance obligations identified in the contract **before** the modification, but only to the extent that the change in transaction price is attributable to an amount of variable consideration prior to the modification.
(b) In all other cases, the entity allocates changes in transaction price to the performance obligations in the modified contract that were unsatisfied (or partially unsatisfied) immediately **after** the modification.

Example: compensation for poor service

Hayes Enterprises Ltd provides its customer, Walker Industries Ltd, with a credit note in the current month because of the poor quality service it has received. Hayes determines that this credit note results in a change in the transaction price as opposed to variable consideration.

As the credit note relates to a previously satisfied performance obligation, it is recognised in full in the month in which it is granted (ie when Hayes promises to pay the consideration).

Example: contract modification

Lowton Ltd provides a new customer, Willows Ltd, with a £750 credit in respect of a two-year contract that it has taken out. The credit is a discretionary gesture and is not in response to any poor levels of service or complaint by the customer.

Lowton does not routinely provide these credits and hence customers do not expect to receive them. Consequently, Lowton concludes that this is a change in transaction price and is not variable consideration.

As the credit does not relate to a satisfied performance obligation, the change in transaction price arising from giving the discretionary credit is accounted for as a contract modification and is recognised over the remaining term of the contract.

If, on the other hand, Lowton decided to provide a monthly discount for the remaining contract term, it would also conclude that it was a change in transaction price. It would then apply the discount over the remaining term of the contract.

Step 5: Recognise revenue when (or as) the entity satisfies a promise

Revenue is recognised when (or as) the entity satisfies a performance obligation by transferring a good or service to a customer. A performance obligation is said to be satisfied **over time** if one of the following criteria in FRS 102, para 23.81 (a) to (c) 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 that the customer controls as the asset is created or enhanced.

(c) The entity's performance does not create an asset with alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

Example: provision of a service over time
Paul's Payroll Services enters into a contract with Wolves Ltd to provide monthly payroll services at a contracted rate of £16,000 per annum. Paul's Payroll Services has a year-end of 30 June 2024. The provision of payroll is a separate performance obligation, which is performed over time. This is because the customer simultaneously receives and consumes the benefit of the payroll service. Even if Wolves Ltd were to change payroll provider, the payroll would not need to be reperformed. Paul's Payroll Services recognises revenue from the service over time. Hence, in the year to 30 June 2024, the entity recognises £8,000 as revenue (£16,000 x 6/12).

If a performance obligation is satisfied over time, revenue is recognised over time based on progress towards the satisfaction of that performance obligation. FRS 102, para 23.102 refers to 'output methods' and 'input methods', and provides the following examples:

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

(b) an output method based on units delivered, when each item transfers an equal amount of value to the customer on delivery and partly completed items are not significant

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

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

(e) an input method based on costs incurred, when the method includes costs that reflect an entity's performance to date and contribute to the entity's progress in transferring control of goods or services promised to a customer

(f) an input method based on labour hours expended, when there is a relationship between labour hours expended and the transfer of control of goods or services to a customer.

Where progress cannot be reliably measured, revenue must only be recognised up to the recoverable costs incurred.

Example: contract performed over time

On 3 January 2026, Dwyer Ltd enters into a contract with Whitaker Ltd to construct a new building for £8m plus a bonus of £1m if the building is completed within 18 months. Estimated costs to construct the building have been calculated at £6m.

The winter months are renowned for causing delays to construction, and sourcing various materials can also be problematic at times, which can contribute to delays in construction. Hence, Dwyer is uncertain whether the bonus will be received.

At the year end 31 December 2026, Dwyer is still uncertain whether its bonus target will be achieved due to other delays during the year, such as staffing issues and breakdowns of machinery. Dwyer decides to measure progress towards completion based on costs incurred (FRS 102, para 23.102(e)). Costs incurred on the contract to date are £2m.

The construction of the building is a single-performance obligation. The bonus element is variable consideration and must be excluded from the transaction price because it is not highly probable that it will be entitled to the cumulative amount of revenue (FRS 102, para 23.46).

The construction is accounted for as an obligation performed over time. Dwyer should recognise revenue based on progress towards satisfaction of the construction of the building. Using the costs incurred approach, the performance obligation is 1/3 (£2m/£6m) complete. Accordingly, revenue and costs recognised at the year-end are:

		£m
Revenue	(£8m x 1/3)	2.6
Costs	(£6m x 1/3)	(2.0)
Gross profit		0.6

If a performance obligation is not satisfied over time, then it is satisfied at a point in time. The entity must determine the point in time at which a customer obtains control of a promised asset. FRS 102, para 23.85 provides the following (non-comprehensive) indicators of a transfer of control:

(a) The entity has a present right to payment for the asset.
(b) The customer has legal title to the asset.
(c) The customer has physical possession of the asset.
(d) The customer has the significant risks and rewards of ownership of the asset.
(e) The customer has accepted the asset.

ACCA Comment

Possession of legal title of goods is a protective right and this may not necessarily coincide with the transfer of control of the goods or services to a customer. This commonly arises when the seller retains legal title to protect against the risk that the customer does not pay for the goods and/or services.

The indicators of control within FRS 102, para 23.85 are factors that are often present where a customer controls an asset. It must be emphasised that they are not individually determinative, nor are they a list of conditions that must be met; they are purely examples to guide preparers into making the right conclusion. To that end, professional judgement will be required by the entity to determine the point in time at which control is transferred to the customer.

Customer acceptance

FRS 102, para 23.88 clarifies that customer acceptance clauses allow a customer to cancel a contract or require an entity to take remedial action when a good or service does not meet agreed-upon specifications. Where a contract contains a customer acceptance clause, the entity must consider the effect of the clause when evaluating when a customer obtains control of the asset.

FRS 102, para 23.89 then goes on to provide guidance on the following:

The entity can objectively verify that the goods or services comply with the specifications underlying acceptance of the goods and/or services.	The customer acceptance is a formality that does not affect the entity's determination of when the customer has obtained control of the good or service.
The entity cannot objectively determine whether the specifications have been met.	The entity cannot conclude that the customer has obtained control until the entity receives the customer's acceptance.

Repurchase agreements

A repurchase agreement is a contract in which an entity sells an asset and also promises (or has the option) to repurchase the asset. FRS 102, para 23.90 requires the entity to consider any repurchase agreements when evaluating whether a customer obtains control of an asset.

ACCA comment

If the repurchase agreement meets the definition of a 'financial instrument', then it is outside the scope of FRS 102, section 23. If not, the repurchase agreement is in scope of FRS 102, section 23 and the accounting treatment will depend on its type, such as a forward contract, call option or put option, as well as the repurchase price.

Forward or call option

Where the entity has an obligation or a right to repurchase an asset (a forward or a call option), the customer does not obtain control of the asset, and the entity does not recognise revenue. The entity must account for the contract as either:

(a) a lease in accordance with FRS 102, section 20, *Leases* if the entity can (or must) repurchase the asset for an amount less than the original selling price of the asset. As an exception, the entity accounts for the contract in accordance with FRS 102, para 20.122 if the contract forms part of a sale and leaseback arrangement

(b) a financing arrangement in accordance with FRS 102, para 23.93 if the entity can, or must, repurchase the asset for an amount equivalent to, or more than, the original selling price of the asset.

Forward
(a seller's obligation to repurchase the asset)

Call option
(a seller's right to repurchase the asset)

The customer does not obtain control of the asset

Is the asset repurchased for less than original selling price?

Yes

Account for the transaction as a lease arrangement (unless the contract is part of a sale and leaseback transaction)

No

Account for the transaction as a financing arrangement

Where the repurchase agreement is a financing arrangement, the entity recognises a financial liability for any consideration received by the customer, ie:

- Dr Cash at bank X
- Cr Financial liabilities X

The difference between the consideration received from (and to be paid to) the customer is recognised as interest using the effective interest method per FRS 102, section 11.

Put option
Where a customer has the right to require the entity to repurchase the asset (ie a put option) at a price that is lower than the original selling price, then, at contract inception, the entity must assess whether the customer has a significant economic incentive to exercise the right. In making this assessment, the entity considers various factors which include:

- the relationship of the repurchase price to the expected market value of the asset at the date of repurchase
- the amount of time until the right expires.

Where the customer has a significant economic incentive to exercise the put option, the entity accounts for the agreement as a lease (unless the contract is part of a sale and leaseback transaction) or a financing arrangement depending on the relationship between the amount the entity may be required to pay to repurchase the asset and its original selling price. If the customer does not have a significant economic incentive, the entity accounts for the agreement as the sale of a product with a right of return.

Example: mobile phone trade-in
AB Fones enters into a two-year contract with a customer to provide a handset and mobile phone services. On inception of the contract, AB Fones transfers a handset worth £700, together with a right to trade that handset in for £100 at the end of the service contract.

The stand-alone selling price of the handset at the start of the contract is £700 and AB Fones expects the market value of the handset to be £150 in two years' time.

AB Fones' obligation to repurchase the handset at the customer's option is a put option. At the inception of the contract, AB Fones must assess whether the customer has a significant economic incentive to exercise the put option, which will then lead into the correct accounting treatment.

AB Fones concludes that the customer does not have a significant incentive to exercise the put option because the repurchase price of £100 is lower than market value. In addition, customers can generally sell handsets for more than their trade-in value on various online platforms. AB Fones concludes that there are no relevant factors to consider when assessing whether the customer has a significant economic incentive to exercise the put option.

AB Fones concludes that control of the handset transfers to the customer. This is because the customer is not limited in its ability to direct the use of and obtain (substantially) all of the remaining benefits, from the handset.

AB Fones accounts for the transaction as a sale with a right of return.

Licensing

FRS 102, para 23.105 confirms that a licence establishes a customer's right to use intellectual property belonging to an entity and provides various examples as follows:

- software
- technology
- trademarks
- patents
- franchises
- music
- motion picture films.

FRS 102, para 23.106 requires the entity to determine whether a licence is distinct or otherwise in order to apply the correct accounting treatment. This will include an assessment of whether the:

(a) customer can benefit from the licence on its own or together with other resources that are readily available
(b) the licence is separately identifiable from other goods or services in the contract.

Where a licence is not distinct, the entity recognises revenue for the single performance obligation when, or as, the combined goods or services are transferred to the customer. This will usually mean applying step 5 of the five-step model to determine whether the performance obligation containing the licence is satisfied over time or at a point in time.

Examples of licences that are not distinct include:

- licences that form part of a tangible good and are integral to the functionality of the good – such as software embedded in the operating system of a computer
- licences that the customer can benefit from only in conjunction with a related service – such as media content that a customer can access via an online portal.

Where a licence is not distinct, the entity applies FRS 102, paras 23.78 to 23.89 to determine whether the performance obligation (including the licence) is satisfied over time or at a point in time.

Where a licence is distinct, the entity applies FRS 102, paras 23.17 to 23.25 to identify each of the performance obligations in the contract. It must also apply paragraphs 23.107 to 23.112 to determine whether the performance obligation is satisfied over time or at a point in time.

The entity considers whether the nature of the promises in granting the licence provides the customer with:

(a) a right to access the entity's intellectual property as it exists throughout the licence period, or
(b) a right to use the entity's intellectual property as it exists at the point in time at which the licence is granted.

FRS 102, para 23.108 clarifies that a licence provides a customer with a right to access the entity's intellectual property if the entity expects to undertake activities that either:

(a) will significantly affect the benefit the customer obtains from the intellectual property by changing the substance of the intellectual property, or
(b) could significantly affect the benefit the customer obtains from the intellectual property by directly exposing the customer to any positive or negative effects of those activities.

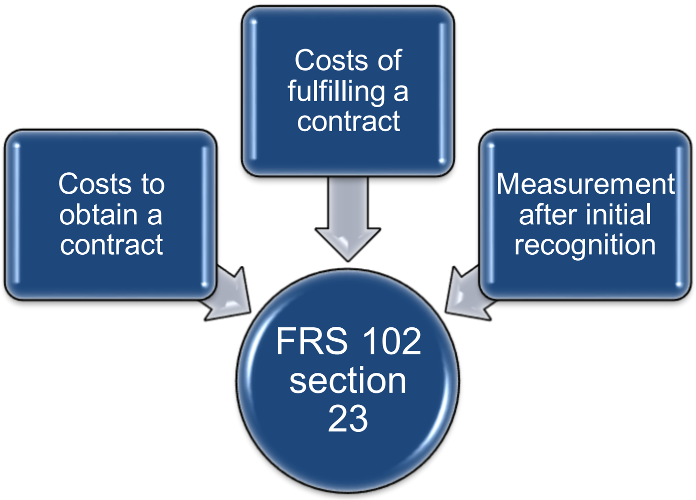
If any of the criteria above are met, the licence will transfer over time. If neither of the above are met, the licence provides the customer with a right to use the entity's intellectual property as it exists **at the point in time** at which the licence is granted.

Timing of revenue recognition	Reasons
At a point in time	The entity recognises revenue at a point in time because there is no explicit or implicit obligation for the entity to undertake activities during the licence period to change the form or functionality of the intellectual property or support or maintain the value of the intellectual property during the licence period. Examples include: • software • copies of TV shows • copies of music • biological compounds.

Over time	Revenue is recognised over time as the intellectual property's design or functionality changes over time. In addition, the customer's ability to obtain benefits from the intellectual property derives from, or is dependent on, the company's ongoing activities that are to be performed over the licence period. Examples include: • franchise rights • brand names • logos • team names.

Contract costs

FRS 102, section 23 does not provide comprehensive guidance on how an entity should account for contract costs as, in many cases, an entity will account for contract costs in line with other sections of the standard (eg section 13, *Inventories*). However, there is specific guidance in the following areas:



Costs to obtain a contract

As an accounting policy choice, an entity may capitalise directly attributable costs of obtaining a contract with a customer if the costs would not have been incurred by the entity if the contract had not been obtained and the costs can be recovered.

Any costs that do not meet this recognition criteria are recognised as an expense as incurred. This includes any costs the entity incurs in *trying* to obtain a contract.

Where an entity adopts a capitalisation policy of such costs, that policy must be applied consistently to all costs that meet the recognition criteria. The only exception would be in respect of costs that the entity would recognise as an asset with an amortisation period of one year or less. (Such costs can be expensed when incurred.)

Example: costs incurred in obtaining a contract	
Currie Consulting Ltd provides professional HR consultancy services to its client base. It has recently been awarded a contract to provide HR consultancy services to a large corporate client and incurs the following costs to obtain the contract:	

	£
Due diligence fees	1,750
Professional fees to prepare the presentation	850
Commissions to marketing employees including tax	2,850

The due diligence fees and professional fees to prepare the presentation are costs the entity has incurred in trying to secure the contract. These are costs that the entity would suffer even if it had not been awarded the contract, so they are written off to profit or loss as incurred.

The commissions to marketing employees are incremental costs in obtaining the contract as they are payable on being successful in the tender. Hence, Currie Consulting recognises an asset for the commissions of £2,850, subject to recoverability.

Costs of fulfilling a contract

FRS 102, para 23.116 states that an entity accounts for the costs incurred in fulfilling a contract with the relevant section (eg section 13, *Inventories*, section 17, *Property, Plant and Equipment*, or section 18, *Intangible Assets other than Goodwill*).

Where the costs of fulfilling a contract are not in scope of those sections, the entity recognises those costs as an asset if:

- the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify
- the costs generate or enhance resources of the entity that will be used in satisfying (or continuing to satisfy) performance obligations in the future
- the costs are expected to be recovered.

Direct costs eligible for capitalisation provided other criteria are met	Costs that must be expensed to profit or loss as incurred
Direct labour (employee wages/salaries)	General administrative costs, unless they are explicitly chargeable under the contract
Direct materials such as supplies	Costs that relate to satisfied, or partially satisfied, performance obligations
Allocation of costs that relate directly to the contract such as depreciation and amortisation	Costs of wasted materials, labour or other contract costs
Other costs that have been incurred only because the entity entered into the contract, such as sub-contractor costs	Costs that do not clearly relate to unsatisfied or partially satisfied performance obligations

Example: construction of a new data management system

Howard Homes Ltd acts as an intermediary between a landlord and tenant in providing social housing. Due to demand for its services and the awarding of several contracts in the past two years, the company has commissioned an IT company to develop and install a new data management system. Once installed, the IT company will continue to manage the system on behalf of the client. The contract states that the data management system is not transferred to Howard Homes and is not a separate performance obligation.

The initial setup costs include:

- costs of design
- provision of hardware and software
- testing and parallel running.

The IT company accounts for these costs as follows:

Hardware
The cost of the hardware is accounted for under FRS 102, section 17.

Software
The cost of the software is accounted for under FRS 102, section 18.

Design, testing and parallel running
These are capitalised under FRS 102, section 23 as they:
- relate directly to the contract
- generate resources for the entity that will be used to satisfy future performance obligations
- are expected to be recovered over the five-year contract period.

Measurement after recognition

FRS 102, para 23.119 states that an entity shall measure recognised assets at cost less accumulated amortisation and accumulated impairment losses. The amortisation method is based on the pattern of transfer to the customer of the goods or services to which the asset relates.

Impairment requirements are dealt with in FRS 102, section 27, *Impairment of Assets*. However, FRS 102, para 23.121 clarifies that the entity must apply paragraph 23.122 instead of paragraphs 27.11 to 27.20A in estimating recoverable amount. Recoverable amount of an asset recognised in accordance with paragraphs 23.113 or 23.117 is:

(a) the remaining amount of consideration that the entity expects to receive in exchange for goods or services to which the asset relates, less

(b) the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

Keep in mind that where (a) above is concerned, the entity must determine the amount of consideration that the entity expects to receive using the principles for determining transaction price (with the exception of the requirements in FRS 102, para 23.46 on constraining estimates of variable consideration) and adjusting that amount to reflect the customer's credit risk.

Contract balances

Contract balances can be an asset or a liability in the financial statements, depending on the entity's performance in transferring goods or services to the customer and the customer's payment profile.

A contract liability is recognised when…	A contract asset is recognised when…
Consideration has been received from the customer prior to the entity transferring goods or services to the customer. A liability is recognised at the **earlier** of payment being made or payment becoming due.	The entity transfers goods or services to a customer before the customer pays (or before payment is due). The asset is derecognised when the customer pays. The entity must assess a contract asset for impairment and recognise any impairment loss in profit or loss in accordance with section 11, *Basic Financial Instruments*.

Where the entity receives a non-refundable upfront payment, this gives rise to a contract liability. FRS 102, para 23.129 recognises that some customers may not exercise all of their contractual rights, and those unexercised rights are referred to as 'breakage'.

An entity considers the requirements in FRS 102, para 23.46 where it expects to be entitled to a breakage amount in a contract. If the entity expects to be entitled to a breakage amount, it recognises the expected breakage amount as revenue in proportion to the pattern of rights exercised by the customer. Where the entity does not expect to be entitled to a breakage amount, the entity recognises revenue when the likelihood of the customer exercising its remaining rights becomes remote.

ACCA comment
FRS 102, para 23.130 refers to the term 'remote'. This is not a defined term in the standard. It is considered to be a subset of 'possible', which is at the lower end of the scale of probability ('probable' being defined as 'more likely than not'). Remote is to be taken to mean that the event is not expected to occur, but it cannot be ruled out completely.

Updated May 2025