



Technical Alert

FRS 102 periodic review amendments



Introduction

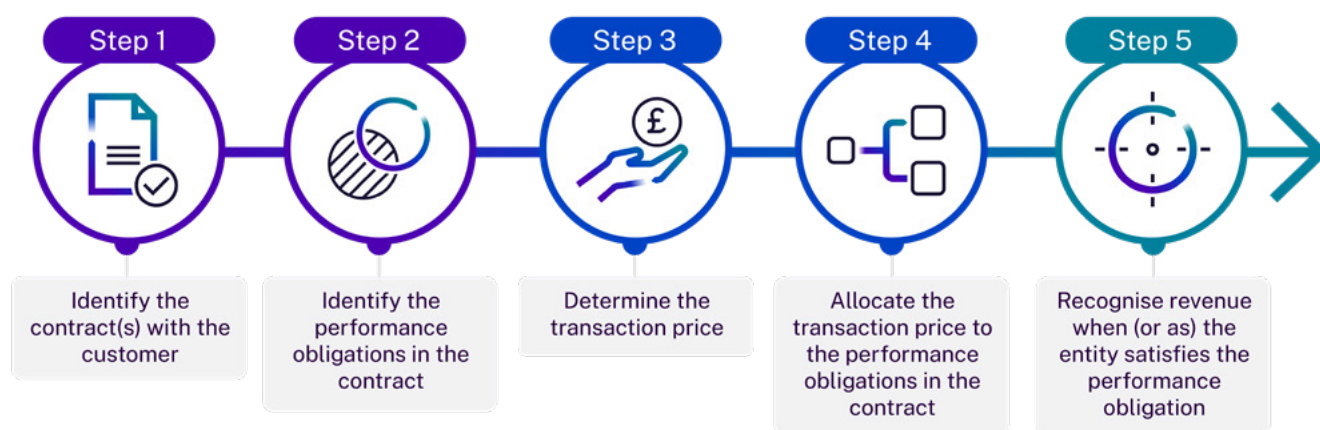
The amendments to FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and other FRSs – Periodic Review 2024 (the periodic review) introduced various changes, with a key change to the revenue reporting standard. This publication focusses on the change to Section 23 Revenue from contracts with customers (Section 23).

A summary of other changes related to the periodic review can be found in the FRS 102 Overview [Alert](#).

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A new five-step revenue recognition model based on IFRS 15 Revenue from Contracts with Customers (with some simplifications) is introduced as follows:



Revenue recognised under the previous Section 23 Revenue was based on two models; one for goods based on a transfer of risks and rewards and one for services and construction contracts, based on a 'percentage of completion' basis. The new standard is based on a single revenue recognition model to depict the transfer of promised goods or services to the customer. The change is a fundamental shift from “what has

been done to earn revenue?” to “what has the customer received?”. The new model provides a more detailed framework and prescriptive guidance than the previous Section 23, which may mean changes to the timing and profile of revenue recognition. In addition to the five-step model, the new standard introduces guidance related to contract balances and costs, and disclosure requirements.



S&W observations – Application of revised Section 23

The application of the revised Section 23 is pervasive for all entities with revenue and all steps of the five-step model need to be assessed. Whilst all steps need to be assessed, some steps may have a more significant impact than others and may involve judgements and estimation uncertainty. The new requirements will likely not result in a change in aggregate revenue recognition over the life of the contract. However, entities need to assess the five-step model carefully as the timing and/or measurement of revenue recognition in a reporting period during the contract may change. For example, where new distinct performance obligations are identified, the timing of revenue recognition for these performance obligations may not be in line with that per the previous accounting policies.

The new revenue recognition model may have a wider impact on entities. For example, new or revised data may be required, to identify distinct performance obligations and to allocate the transaction price to these performance obligations. Entities will need to consider how such information is collated and maintained, in some cases, an excel sheet shall suffice whilst more complex scenarios might require updates to systems and processes. Moreover, teams outside the finance team may require an understanding of the new revenue recognition model when negotiating or pricing contracts.

Summary - New five-step model

Each of the five steps are summarised below.

Step	Summary
1. Identify the contract(s) with the customer (paragraphs 23.7-23.16)	<p>An entity is required to assess whether an agreement is a “contract with a customer”, when multiple contracts should be considered together (i.e. bundled); and whether a modification to a contract should be considered to amend an existing contract or be treated as a separate sale.</p>
2. Identify the performance obligations in the contract (paragraphs 23.19 – 23.40)	<p>An entity is required to consider what promises are made in a contract, whether these are “distinct” and accordingly accounted for separately.</p> <p>A good or service is considered distinct if the customer can benefit from the good or service, either on its own or with other resources readily available, and the promise is separately identifiable from other promises in the contract.</p>
3. Determine the transaction price (paragraphs 23.41 – 23.64)	<p>The transaction price is the amount of consideration the entity expects to be entitled to receive under the contract. It therefore ignores collection problems (which are to be dealt with under Sections 11 and 12). It does include variable consideration (see below) and the time value of money if a significant financing component is present (which is where the recognition of revenue is at least 12 months before or after the receipt of consideration).</p> <p>Variable consideration is estimated and included only to the extent that it is highly probable that a significant reversal in the cumulative revenue recognised will not occur when the variable amount is subsequently determined. Variable consideration is updated annually as circumstances change.</p>
4. Allocate the transaction price to the performance obligations in the contract (paragraphs 23.65 – 23.77)	<p>The allocation of the total price to performance obligations is typically done based on relative stand-alone selling prices, which may need to be estimated as some performance obligations are never, in practice, sold on their own. In some cases, a discount applied, or a variable consideration element of a contract may relate specifically to certain performance obligations, in which case that discount or variable element is applied first.</p>
5. Recognise revenue when (or as) the entity satisfies the performance obligation (paragraphs 23.65 – 23.77)	<p>If a performance obligation meets one of three criteria (as outlined in section 5.1 below), then revenue is recognised over time. An appropriate method needs to be determined for how to spread such revenue. Where the performance obligation is not satisfied over time, it is satisfied at a point in time. Guidance is included to determine when the appropriate point in time is, and consequently, when revenue is recognised. This section also deals with recognising revenue related to licenses.</p>

Step 1 – Identify the contract(s) with the customer

1. Step 1 – Identify the contract(s) with the customer

1.1. Contract with a customer

Section 23 applies to contracts with customers and therefore it is first necessary to determine whether such a contract exists. All the following conditions (per paragraph 23.7) need to be met at inception to evidence the existence of a contract:

- a) The parties to the contract have approved the contract and are committed to perform their respective obligations
- b) Each party's rights regarding goods or services to be transferred can be identified by the entity
- c) The payment terms for the goods or services to be transferred can be identified by the entity
- d) The contract has commercial substance
- e) It is probable that the customer will have the ability and intention to pay the consideration agreed when it is due

A key factor to meeting the above criteria is that the contract is enforceable. If the contract can be no longer enforced, then Section 23 will cease to apply (other sections may apply). If the contract is not yet enforceable, (for example where neither party has yet performed or paid consideration and both parties would exit without compensation falling due), the contract is considered to not yet exist. If a customer pays in advance of a contract meeting the criteria

above, the consideration received is recognised as a liability until all criteria has been met.

The criterion per (e) doesn't mean that revenue is not recognised where there is a potential bad debt. Rather, if it is probable a supplier will not be paid, it is unlikely that the goods or services will be supplied in the first instance.

Reassessment of whether a contract meets the criteria is only required if there is an indication of a significant change in relevant circumstances and facts. The model can be applied to a portfolio of similar contracts or performance obligations, provided that doing so would not result in a material difference to applying the model to an individual contract, or performance obligation, within that portfolio.

1.2. Combining contracts

Whilst Section 23 uses the concept of performance obligation (see section 2 below), contracts entered at or near the same time with the same customer (or related parties of the customer) are combined if:

- a) They are negotiated as a package with a single commercial objective
- b) The consideration depends on the price or performance of the other contract
- c) The contracts form a single performance obligation



Example - Combining contracts

Citybuild Limited enters a contract to provide building materials for the construction of an apartment block to Homes Limited. At the same time, Citybuild Limited also enters two contracts to construct the apartment block and to complete the landscaping around the apartment block with a wholly owned subsidiary of Homes Limited. These contracts are entered into near the same time with related parties and are negotiated with a single commercial objective of delivering a fully constructed apartment block. Consequently, the contracts are combined.

1.3. Contract modifications

A contract modification is a change in the scope or price (or both) of a contract that the parties approve.

For example, this may arise due to a change in orders, variations, additional services or scope creep. The table below summarises the treatment.

Criteria	Accounting treatment
Modification adds distinct goods or services and the change in price reflects a stand-alone selling price.	Account for modification as a separate contract.
Modification does not meet the criteria for a new contract and the remaining goods or services are distinct from those already transferred.	Modification accounted for prospectively - the existing contract is terminated and replaced with a new contract.
Modification does not meet the criteria for a new contract and the remaining goods or services are not distinct from those already transferred.	Cumulative catch-up adjustment applied (i.e. adjustment to cumulative revenue recognised) – the modification is treated as if it was always part of the existing contract.
Modification does not meet the criteria for a new contract and remaining goods or services are a combination of distinct and not distinct goods or services.	Combination of new contract accounting for distinct goods or services and cumulative catch-up for goods or services that are not distinct.



Example - Modification

A customer agreed to pay for construction by Builders Limited of a two storey house on their land for a price of £100,000. Just before Builders Limited 's 200X year end, construction was 50% complete. It was then agreed to add a garage with a second storey above for an additional £50,000. The revised stage of completion was now 40%, as the existing foundations could support the additional elements of the house.

The construction of the house on the customer's land is considered a single performance obligation and the associated revenue would be recognised over time, likely using a stage of completion assessment. The change does not meet the criteria for a new contract and the remaining service (i.e. construction of the garage) is not distinct. Consequently, the modification is treated as if it was always part of the contract.

Revenue for 200X would have been recognised at £50,000 before the modification but is reassessed as being 40% of the combined £150,000 price. Revenue is adjusted to £60,000 with the additional £10,000 being a 'catch up' of revenue.

2. Step 2 – Identify the performance obligation in the contract

2.1. Identifying performance obligations

The revenue recognition model is applied to each distinct performance obligation. A performance obligation is a promise to transfer a distinct good or service, or a series of distinct goods or services. The performance obligations in the contract are identified at inception.

Generally, the contract will explicitly state the promised goods or services, however this may be implied based on customary business practices, published policies or specific statements. Activities to fulfil a contract are only included if they are to transfer a good or service. For example, administrative and set-up activities which do not transfer a good or service to a customer would be disregarded for the purpose of identifying performance obligations in a contract.

2.2. Distinct goods or services

A good or service is distinct if **both** of the following criteria are met:

a) The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer

b) The entity's promise to transfer the good or service is separate from other promises in the contract

Criterion (a) above is met where goods or services are sold

separately regularly. Criterion (b) is based on whether the nature of the promise is to transfer goods or services individually, rather than to transfer a combined item or items that the good or service is an input.

The assessment of whether a good or service is distinct may involve judgement and is often referred to as “unbundling”. Old FRS 102 had a principle of recognising revenue related to “separately identifiable components”, however there was no detailed guidance in this area. Revised Section 23 is more prescriptive, as explained alongside.

Indicators of goods or services that are inputs to a combined item (i.e. the good or service is not distinct) include:

a) A significant service of integrating goods or services with other promised goods or services to deliver the output specified by the customer

b) One or more of the goods or services significantly modifies or customises other promised goods or services

c) The goods or services are highly interdependent or highly interrelated



Example – Distinct goods/services

Entity A enters a contract to provide a piece of machinery for a customer. The customer uses this machinery in their manufacturing process, and it is operational without any significant customisation or modification. Entity A also enters a contract to provide special parts for the use in the machinery, at specified dates of the next two years. The parts are only produced by the entity but are regularly sold separately by the entity. The customer already has similar machines and the parts could be used in any machines of this type. The customer can benefit from the machine alone, or together with special parts, and the promise to transfer the parts is separate from the promise to transfer the machinery. Additionally, the machine and the parts are sold separately regularly. Consequently, the machinery and the parts are distinct goods.

If the use of the machine was highly dependent on the receipt of the special parts, and the entity regularly sold the machine together with the special parts together, these items would be “bundled” together and would not constitute distinct performance obligations. Instead, the machine and special parts would be considered one single performance obligation.

If a good or service is not distinct, it is combined with other goods or services to identify a distinct bundle of goods or services. In some cases, this bundle may comprise all the goods or services in the contract and so the contract would have a single performance obligation.

2.3. Warranties

An entity shall account for a warranty in accordance with Section 21 Provisions and contingencies unless the warranty, or part thereof

provides the customer with an additional service. The additional service is incremental to the product operating based on the agreed upon specifications (i.e. the warranty is considered a service-type warranty rather than providing assurance that a product sold will work as intended).

To assess whether the warranty provides the customer with an additional service, the following indicators are considered:

Additional service indicators	Assurance indicators
Separate purchase option (i.e. the customer purchasing the warranty separately)	Legal requirement where the warranty is required by law
Coverage length (longer warranty periods are likely to be additional services)	Tasks to ensure the product meets specifications (for example, return shipping for defects)

Where the warranty provides an additional service, that additional service is a separate performance obligation. If the warranty provides for both an additional services and assurance that the product operates

based on the agreed specifications, but these cannot be reasonably accounted for separately, they are combined as a single performance obligation.

2.4. Non-refundable upfront fees

Entities may charge a non-refundable fee at the start of a contract, for example, joining fees for a gym or set-up fees for services. Often, this fee doesn't mean the customer receives something right away; instead, it's an advance payment for future services or goods. The entity will recognise this

fee as revenue when they provide those future services or goods. If the fee gives the customer a special benefit for the future, like a discount or special access, the revenue might be spread out over a longer period. If the fee is for something specific that the customer receives right away, the entity needs to decide if it should be treated as a separate part of the contract.



Example – Non-refundable upfront fees

An individual joins a health club and pays a £150 non-refundable joining fee. This fee doesn't give that individual any immediate benefits but allows access the club's facilities for the next year. In addition to the joining fee, the individual also must pay a charge of £1,200 to access the health club for one year (monthly fee of £100), irrespective of whether they attend or not.

The health club will recognise this £150 as a contract liability on receipt and will recognise revenue over the year as the performance obligation (the health club being available for the customer) is satisfied. If the joining fee provided a free personal training session, that session can be separately identified from the club membership. Therefore, a proportion of the £150 joining fee would be allocated to this performance obligation (see section 4).

If the joining fee was only paid once and the customer could enter a second-year contract without paying the joining fee (i.e. the customer would only pay the monthly fee of £100 in the second year), the customer is receiving a material right (see section 2.6) for future years. In this instance, the joining fee would be recognised as revenue over a longer period as the performance obligation is satisfied.

2.5. Stand-ready to provide goods or services

An entity may "stand-ready" to provide goods or services for a period, rather than provide the goods or services underlying the obligation. An indicator of an entity having a stand-ready obligation is where the entity is required to deliver goods/services where the customer calls for them, or upon the occurrence of a contingent event where in either case, the entity will not know how the customer will receive the goods/services during the contract term. A stand-ready obligation needs to be assessed

as to whether it is a distinct performance obligation based on the nature of the promises in the contract.





Example – “Stand-ready” obligation

Using the facts in the example immediately above, the health club is “standing ready” to provide services of access to gym facilities, fitness classes and training sessions during the one-year membership period. The health club has a stand-ready obligation because they are available to provide the services when the customer decides to use them.

2.6. Customer options for additional goods or services (“material rights”)

A contract that gives customers an option to buy additional goods or services for free or a discount may be considered to have a material right. A material right is considered a significant benefit that the customer would not obtain without entering the contract. Examples of options that provide a material right to customers include sales incentives, customer award credits (or points), contract renewal options or other discounts on future goods or services.

If an option does provide a material right, the customer is in effect paying in advance for future goods and services. The material right is treated as a separate performance obligation and revenue is recognised when those goods or services are transferred (or when the option expires). An option that allows customers to buy goods/services at their standalone price doesn’t provide a material right and isn’t treated as a separate performance obligation.



Example – Material right

A meal delivery subscription costs a customer £120 per month. The provider offers an option to acquire an additional month at a 50% discount (£60), which is only available because the customer entered the original contract. This discount is a significant benefit that the customer would not obtain without entering the contract and therefore, it provides the customer with a material right. The material right creates a separate performance obligation for the provider that is accounted for separately to the monthly subscription. Part of the monthly fee of £120 will be allocated to the revenue for the delivered meals and the discount. Revenue for the material right would be accounted for when the customer redeems the discount or when the right expires unused.

2.7. Agent vs principal

The concept of agent vs principal is not new. However, the revised Section 23 provides for guidance based on the assessment of control, and the indicators should not be viewed in isolation. An entity that is a principal recognises revenue based on the gross amount of consideration, whilst an entity that is an agent recognises revenue based on its fee or commission. An entity is considered a principal if it controls the good/service before transferring it to the customer. This control can be over:

- a) A good or asset obtained from another party and then transferred to the customer
- b) A right to a service performed by another party, allowing the entity to direct the service on its behalf
- c) A good or service from another party, that is combined with other goods or services to provide the specified good or service to the customer

Indicators that an entity is a principal include:

- a) Being primarily responsible for fulfilling the promise to provide the specified good or service
- b) Having inventory risk before or after the transfer of control to the customer (e.g. if the customer has a right of return)
- c) Having discretion in setting the price for the specified good or service

Revised Section 23 removed the assessment of whether the entity bears the customer's credit risk for the amount receivable from the customer as an indicator of a principal relationship.

Step 3 –
Determine the
transaction price



3. Step 3 – Determine the transaction price

The transaction price is the amount of consideration that the entity expects to be entitled to, in exchange for transferring goods or services promised to the customer. This excludes amounts collected on behalf of third parties (for example, VAT or similar taxes).

3.1. Variable consideration

The consideration in contracts may vary due to items such as discounts, rebates, refunds, penalties or bonuses. An entity shall estimate the variable amount in the transaction price and update this estimate at the end of each reporting period. To estimate

variable consideration, an entity first needs to determine an appropriate amount of variable consideration and then consider whether this amount should be constrained.

3.1.1. Determine an appropriate method

There are two methods to determine the transaction price, as reflected below. The method selected should be based on whichever method will better predict the amount of consideration that the entity will be entitled to. Only one method can be applied for each contract, and this method should be applied consistently.

Method	Definition	When is this method appropriate?
Expected value	Sum of the probability-weighted amounts in a range of possible consideration amounts.	Many contracts with similar characteristics, for example, where refunds are predictable across a population of sales.
Most-likely amount	Single most likely amount in a range of possible consideration amounts.	Contracts with only two possible outcomes, for example, where a performance bonus is achieved or not.

The estimate of variable consideration should be based on all available information, including historic information such as trend results, current information and forecast results where such information is reasonably available (it is not a requirement to create some forecasts if none are reasonably available).

3.1.2. Consider any variable consideration constraint

After estimating the variable consideration, entities must apply a

constraint. This means they should only include the variable amount in the transaction price if 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. In other words, where an entity earns variable revenue from a contract, for example, a contract that includes a bonus, then the variable consideration is only included in revenue where it is very likely it will be received. This helps ensure that revenue recognised is

reliable and not overly optimistic.

Section 23 contains detailed requirements for specific types of variable consideration, including sales or usage-based royalties, refunds and sales with a right of return.

3.1.3. Sales-based or usage-based royalties

Where an entity licences items such as software, music or patents and is paid based on how much the customer uses or sells the products that include the intellectual property, revenue is recognised at a later date to when the intellectual property is handed over. Usually, the performance obligation is satisfied or partially satisfied when the intellectual property is handed over and so the critical consideration for recognising revenue is the subsequent sale or usage. Therefore, where the licence of intellectual property is the sole or predominant item which a royalty relates, an entity recognises revenue when the later of these events occurs:

- a) The sale or usage
- b) The related performance obligation is satisfied (or partially satisfied)

3.1.4. Refund liabilities and sale with a right of return

A refund liability is recognised where an entity receives consideration from a customer but expects to refund some or all of the consideration. For example, an entity may have a fixed-price service contract that requires an upfront fee, but the entity may provide the customer with a refund if the customer is dissatisfied with

the service at any time. The refund liability is measured based on the amount of consideration received to which the entity does not expect to be entitled.

Revenue from the transfer of products with a right of return (and some services that are provided subject to a refund), is recognised based on the following:

- Revenue only for products expected not be returned
- A refund liability for the consideration received (or receivable) for products expected to be returned
- A refund asset, classified as inventory, for products expected to be returned (with a corresponding adjustment to cost of sales)

The recognition of a refund asset is a change to previous accounting under the old Section 23. This refund asset is initially measured at the former carrying amount of the product (i.e. inventory value released to cost of sales on the original sale), less:

- Any expected costs to recover the products
- Any allowances for potential decreases to the value of the products (i.e. an inventory provision for damage, obsolescence or decreased selling prices)

3.2. Non-cash consideration

Non-cash consideration is measured at fair value. If fair value cannot be measured, the consideration is measured indirectly with reference to the stand-alone selling price of goods or services promised to the customer.

3.3. Time value of money

If payment is deferred beyond normal terms of business, or is financed by the entity at a rate that is not a market rate, the arrangement is a financing arrangement. An adjustment to the promised consideration for the effects of time value of money is not required if, at contract inception, the period between when the entity transfers the good or service and when the consideration is received is 12 months or less.

The consideration is adjusted for the effects of time value of money, and interest income is recognised separately from revenue from contracts with customers. If a payment is received in advance, an entity may adjust the amount of consideration received for time value of money (i.e. recognise an interest expense).



3.4. Consideration payable to a customer

Consideration payable to a customer includes cash, credit or other items such as a coupon or voucher that can be applied against amounts owed to the entity. Consideration payable to a customer is accounted for a reduction in the transaction price unless the payment is for a distinct good or service provided from the customer to the entity. A reduction in revenue is accounted for at the later of:

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

Step 4 –
Determine the
transaction price



4. Step 4 – Determine the transaction price

4.1. Allocation based on stand-alone selling prices

The transaction price is allocated to each performance obligation identified in the contract on a relative stand-alone selling price. This is the selling price at which an entity would sell a good or service in a contract separately to the customer. If a contract only contains one performance obligation, or the performance obligations are all being completed at the same point in time, the transaction price would usually not need to be allocated as the accounting outcome would remain the same. Where there are multiple performance obligations, the transaction price needs to be allocated to each distinct good or service. The stand-alone selling price is based on observable prices, or if not available, a suitable method to estimate it is used. This method shall consider all reasonably

available information, including market conditions, entity-specific factors and information about the customer or class of customer.

Suitable estimation methods may include the following:

- a) Adjusted market assessment** approach which entails, for example, prices that an entity's competitor may charge for similar goods or services adjusted for the entity's own costs and margins
- b) Expected cost plus margin approach** – obtained based the forecast costs with an appropriate margin
- c) Residual approach** - applied only if the stand-alone selling price is highly variable or uncertain



S&W observations – Determining the stand-alone selling price

Determining the stand-alone selling price may involve judgement. The adjusted market assessment may be impacted by discounting patterns, customer segmentation and different competitors in the market. For example, a hotel room selling accommodation may have a listed price on site but may have a customary practice of providing discounts where the rooms are booked through third-party agents or through their website.

The residual approach is usually applied as a “last resort” where other methods are not considered appropriate. There may be times when it is necessary to combine two approaches. For example, a residual method is applied to two performance obligations, but a cost-based approach is then applied to split the residual amount between the two obligations.



Example – Allocation of the stand-alone selling price – Adjusted market assessment

Entity A enters a contract to sell a bundle of products and services (product A, B and service C) to a customer for a total transaction price of £1,000. A competitor sells comparable item as follows:

- Product A -£400
- Product B -£300
- Service C -£500

Assuming entity A has sold the products and services in a similar market to its competitor, with similar mark-ups and cost bases, the total stand-alone selling price for all three performance obligations is £1,200 (£400+£300+500). The transaction price is allocated to each item as follows:

- Product A -£333 ($£400/£1200*£1000$)
- Product B -£250 ($£300/£1200*£1000$)
- Product C -£417 ($£500/£1200*£1000$)



Example – Combined approaches

Widget plc sells GNK and MSE widgets separately. However, the price for GNK and MSE widgets when sold separately can vary between £4 and £48, so a residual method is considered appropriate when these widgets are sold in a bundle. A bundle of five GNK, five MSE and five IG88 widgets are sold together for £200. IG88 widgets are usually sold at £10 each. The cost of a GNK widget is £6 and the cost of an MSE widget is £2. While both (GNK and MSE) are expected to earn a similar margin, as noted this margin varies widely. The price will therefore be estimated as follows:

Total bundle	£200.00	
Observable element	£50.00	(being five IG88 at £10 each)
Residual element	£150.00	
Allocated to GNK widgets	£112.50	(being cost of £6 / total cost of £8) by residual element
Allocated to MSE widgets	£37.50	(being cost of £2 / total cost of £8) by residual element
Standalone price of GNK widget	£22.50	$£112.50 / 5 \text{ widgets}$
Standalone price of MSE widget	£7.50	$£37.50 / 5 \text{ widgets}$

Both prices are within the range of actual selling prices and are therefore considered acceptable. If the residual approach produces a price outside the range of prices observed, it cannot be used.

4.2. Allocation of discounts/ variable consideration and material rights

Any discount or variable consideration is generally allocated to all performance obligations a stand-alone selling price, unless it doesn't depict the consideration that the entity expects to be entitled for each performance obligation. When estimated the stand-alone selling price for a customer's option

to acquire additional or services (see section 2.5 above regarding material rights), the discount obtained on exercising that option shall be adjusted for both:

- Any discount that the customer could receive without exercising the option
- The likelihood that the option will be exercised



Example - Allocation based on stand-alone selling prices

Entity A enters a contract to sell a bundle of products and services (products A, B and service C) to a customer for a total transaction price of £1,000. A competitor sells each item as follows:

- Product A -£400
- Product B -£300
- Service C -£500

The total stand-alone selling price for product A, product B and service C remains at £1,200.

When a customer purchases the bundle, they also receive a voucher to purchase product D at a 20% discount. The stand-alone selling price of product D is £200, and there is a 60% likelihood that the customer will exercise their option.

The discount on exercising the option for product D is £40 (£200 - £160 - being 20% of the stand-alone price). The value attributable to the option based on the likelihood of exercise is £24 (60% of £40).

Therefore, the total standalone selling price of the bundle of products A, B, D and service C is £1,224, being the sum of £1,200 for products A and B, as well as service C and £24 for the option for product D. Of the total stand-alone selling price of £1,224, the proportion allocated to the adjusted option is 1.96% (i.e. £24/£1224). The total transaction price is allocated as follows:

- Product A -£327 ($£400/£1224 * £1000$)
- Product B -£245 ($£300/£1224 * £1000$)
- Product C -£408 ($£500/£1224 * £1000$)
- Option for product D -£20 ($£24/£1224 * £1000$)

When the customer exercises the option, they will pay £160 for product D, entity A will recognise £179.60 (or £19.60 when the voucher expires).

4.3. Changes in the transaction price

The transaction price might change due to, for example, updates to an estimate of variable consideration where circumstances have changed. When there is a change in the transaction price, the change is allocated to the performance obligations in the contract on the same basis as the start of the contract (i.e. the transaction price isn't reallocated based on the stand-alone selling price when the change

occurs). This results in a "cumulative catch-up" of revenue, where amounts allocated to a performance obligation that has already been satisfied are recognised as revenue, or a reduction in revenue, in the period that the transaction price changes.

If a change in the transaction prices arises from a contract modification, this is accounted for based on the principles set out in section 1.3 above.

5. Step 5 – Recognise revenue when (or as) the entity satisfies the performance obligation

At inception of the contract, an entity is required to determine when control transfers for each performance obligation, and whether revenue is recognised over time or at a point in time. A customer obtains control over goods or services when it has the ability to direct the use of and obtain the benefits from the goods or services. If the criteria for recognising revenue over time is not met, revenue is recognised at a point in time.

5.1. Recognising revenue over time

Revenue is recognised over time if one of the following criteria is met (per paragraph 23.81):

a) The customer simultaneously receives and consumes the benefits provided as the entity

performs (see 5.1.1.). If this cannot be readily determined, a performance obligation is satisfied over time if another entity would not need to substantially reperform the work completed to date to fulfil the remaining performance obligation (for example, a freight logistics contract)

b) The entity's performance creates or enhances an asset that the customer controls (see 5.1.2)

c) The entity's performance does not create an asset with alternative use and the entity has an enforceable right to payment for performance completed to date (see 5.1.3). Enforceable right to payment must cover the entity's costs with a reasonable mark-up

5.1.1. Customer simultaneously receives and consumes benefits

As above, a performance obligation is satisfied over time if another supplier would, hypothetically, not have to substantially reperform the

work already done if they took over the contract part-way through. Any contractual or practical issues are ignored and it is assumed that any asset controlled by the supplier, which would remain with the supplier, is not available for use by the hypothetical new supplier.



Example - Customer simultaneously receives and consumes benefits

A vendor owns some custom moulds. These will be kept by the vendor at the end of a contract to produce the moulded product.

If the production of the moulds is not a substantial task, the customer could transfer production to a new vendor who would not need to substantially reperform. Therefore, the customer simultaneously receives and consumes the benefits of the contract and so recognition over time would be permitted.

However, if the moulds are a substantial part of the process, a new vendor would have to re-perform the process of creating the moulds. Therefore, the revenue would only be recognised at a point in time (see section 5.3).

5.1.2. Alternative use to an entity

An asset created by an entity does not have an alternative use if the entity is either contractually restricted from redirecting its use or is practically limited from

redirecting its use because it would incur significant losses from doing so. This assessment is made at contract inception, and shall be reassessed only if there is a contract modification (see section 1.3 above) that substantially changes the performance obligation.



Example - Alternative use to an entity

If a machine is built for a customer but is heavily customised, and to rework it for another customer would incur significant costs, it could meet the “no alternative use” criterion. Assuming the customer has an obligation to pay the vendor, as set out in the next section, revenue would therefore be recognised over time.

However, if the machine could easily be repurposed, or the value is substantially all in components which could be cheaply extracted and reused, it would fail to meet the criterion and revenue recognition would be delayed.

5.1.3. Assessment of an enforceable right

The assessment of an enforceable right to payment for work completed to date may arise from specific terms in the contract or applicable laws. Where a contract is cancellable, an entity is required to assess whether the amount payable by the customer at each cancellation point would be an appropriate amount for the work performed to date. The enforceable right to payment must at least compensate the entity for costs incurred plus a reasonable margin. A reasonable profit margin need not be the same as the expected completed contract margin, but should either be:

- A proportion of that amount to reflect performance to date; or
- A reduced margin (where the contract-specific margin is

above the normal margin the company would expect) to reflect a reasonable return on the cost of capital for similar contracts; or

- The typical profit margin for such contracts

An enforceable right to payment doesn't consider a termination of the contract due to failure to perform as promised (i.e. the contract is cancelled due to non-performance). If the right to payment is not included in the contract, it can still be established from statutory rights or legal precedent, unless the entity's customary business practice of not enforcing the right has made the right unenforceable in their jurisdiction.



Example - Enforceable right to payment

Entity A is writing a marketing campaign, for £2,000, for a customer's product using generic images. However, the campaign cannot practically be used to advertise any alternative products.

If the contract included a clause if the customer were to cancel the campaign, entity A will be entitled to a fixed £1,000 compensation payment. This will not meet the above criteria as it may not deliver a reasonable profit margin.

However, if the contract included a clause that, if the customer cancels the campaign, entity A will be entitled to a payment based on the hours performed at their standard hourly rate. This would meet the criteria, as a standard hourly rate will include a typical profit margin for such contracts.

5.2. Measuring progress where revenue is recognised over time

Revenue is recognised over time by measuring progress towards completing a performance obligation. There are two main methods of measuring such progress:

- **Output methods** – These focus on results achieved. For example, in a construction

contract, this might be the milestone achieved or surveys of performance completed

- **Input methods** – These focus efforts put into completion of the performance obligation. For example, this might include costs incurred, labour hours worked, or resources consumed

The following table provides helpful guidance on when each method might be appropriate.

Measure	Method	When most applicable	Examples
Survey of work completed	Output	Surveys provide an objective measure of performance to date.	Construction of rail track.
Units of items transferred	Output	Each item transfers an equal amount of value to the customer on delivery and party completed items are not significant.	Manufacturing contract for units of production of a product.
Time elapsed	Output	Control for goods or services is transferred evenly over time.	Subscription for a software (right to use – see section 5.5 below)
Time inputted	Input	The entity's efforts or inputs are expended evenly through the performance period.	Cleaning service where the services are provided evenly over time.
Costs incurred	Input	Costs that reflect the entity's performance to date and contribute to the entity's progress in transferring goods or services to a customer.	Construction contract of customised asset.
Labour hours expended	Input	Relationship between labour hours expended and the transfer or control of goods or services to a customer.	Software development company creating a custom application for a client.

Only a single method of measure must be chosen. The method chosen should best reflect the transfer of goods or services to the customer (i.e. how the customer really benefits from the work performed). The method chosen also needs to be applied consistently for similar performance obligations. In some instances, the measure of progress will not correspond to the timing of invoices, and consequently a contract liability or contract asset might be recognised (see section 7). If the progress to completion cannot be measured reliably, but the costs incurred are expected

to be recovered, revenue will be recognised only to the extent that costs are incurred (i.e. at a nil mark-up).



S&W observations – Choosing an appropriate method

Selecting an appropriate method needs to best reflect the transfer of goods or services and only one method for each contract can be applied. For example, an entity that has a construction contract with a customer, where revenue is recognised over time cannot apply both surveys of work completed (output method) and labour hours (input method) for a single performance obligation. In this scenario (and more generally), costs incurred is often used as a measure of progress. Where it is difficult to establish one single method of measuring progress of completion, an entity may need to reconsider whether the appropriate performance obligations are identified (see section 2 above).

5.3. Recognising revenue at a point in time

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time, when the customer obtains control of the promised asset. The following indicators evidence the transfer of control:

- The entity has a present right to payment for the asset
- The customer has a legal title to the asset
- The customer has physical possession of the asset
- The customer has the significant risks and rewards of ownership of the asset
- The customer has accepted the asset

The existence or absence of one indicator above is not determinative in isolation. For example, an entity may retain legal title of an asset as security for non-payment of consideration due, or an entity may retain physical possession in a bill and hold arrangement. Conversely, in a consignment arrangement, a distributor might have physical possession of an asset that the

manufacturer controls.

5.4. Repurchase agreements

A repurchase agreement involves an entity selling an asset with the promise or option to repurchase the asset. The repurchase option can be either in the same contract or another contract, and the repurchased asset may be the original asset sold, an asset that is substantially the same as that asset or another asset of which the asset that was originally sold is a component. These typically are structured as a forward, a call option or a put option. Where a forward or call option is included, the sale cannot be accounted for as revenue until the option expires. The transaction should be treated as:

- A lease (where the repurchase price is below the sale price, taking the time value of money into account)
- A financing arrangement (where the repurchase price is the same or higher than the sale price, taking the time value of money into account)

Where a put option is included, judgement is required as to whether there is a significant economic incentive to exercise the option (for

example if the repurchase price is expected to be above market price). If such an incentive exists, the treatment is the same as for a call option set out above. If not, the treatment is the same as for a sale with a right of return.

5.5. Licencing

A licence encompasses a customer's rights to intellectual property (IP) of an entity, including software, technology, trademarks, patents, franchises, music and motion picture films. An entity is required to consider whether the promise to grant a licence is a separate performance obligation, in relation to other promised services or goods (see section 2 above). If the promise to grant a licence is a distinct performance obligation, specific guidance is provided related to recognising revenue over time or a point in time.

An entity shall consider whether the nature or the promise in granting the licence provides the customer with a **right to access** the entity's IP as it exists throughout the licence periods, or a **right to use** the entity's IP as it exists at the point in time at which the licence is granted.

5.5.1. Right to access

A right to access a licence is evidenced if the entity expects to undertake activities that either:

- Will significantly affect the benefit the customer obtains from the IP
- Could significantly affect the benefit the customer obtains from the IP by directly exposing the customer to any positive or negative effects from those activities

An entity's expected activities don't always need to arise from the contract, this may include activities that a customer reasonably expects the entity to undertake. For example, circumstances where an entity regularly provides updates that change the substance of the intellectual property, or activities that change the intellectual property's design, content or ability to perform a function or task. The assessment above must exclude activities that result in the transfer of goods or services to the customer as those activities occur (i.e. if the goods or services are a separate performance obligation, these should be excluded). If either the above criteria are met, the licence transfers over time as the customer receives and consumes the benefits of providing access to IP (as the entity undertakes activities).



5.5.2. Right to use

If neither of the right to access criteria is met, the licence is a right to use licence and the customer obtains this right at a point in time, which is when revenue is recognised.



Example – Right to access vs right to use

A gaming company licenses a game engine from a software developer. The developer continuously updates the engine with new features, bug fixes and performance improvements during the license period and these are not considered separate performance obligations.

- These updates change the substance of the IP (e.g. new rendering capabilities)
- The customer benefits from ongoing updates and support

Therefore, the license provides a right to access the IP over time.

However, if the same software developer licenses an older version of the game engine with no future updates or support then the IP is static (it doesn't change after the license is granted) and the customer gets the right to use the IP as it exists at the point in time.

Therefore, the licence provides the right to use the IP at a point in time.



Example – Software as a service (SAAS)

SAAS arrangements take different forms but often include continuous access to cloud-hosted software, ongoing updates, bug fixes and customer control. These typically do not transfer control of the software itself to the customer as the customer often sends data to the software hosted by the seller on a service that is controlled by the seller. Therefore, whilst these contracts are often referred to as licence arrangements, they are more akin to a provision of a service to a customer. In such arrangements, revenue is typically recognised over time. This is because the customer receives and consumes the benefit of the service provided and the customer is impacted by ongoing activities of the provider (e.g. maintaining uptime, improving features) (see section 5.1 above).

Contract
costs



S&W observations – Licencing and distinct performance obligations

Often software arrangements will comprise several promises such as the provision of installation, standing-ready to provide updates, training and ongoing maintenance. The assessment of whether the licence is a right to access, or right to use, is performed for each distinct performance obligation and one performance obligation cannot be bifurcated into both a right to access and a right to use licence.

For example, if an entity provides one performance obligation of licencing its IP and providing the customer with continuous performance improvements, the customer has a right of access and revenue is recognised over time. The entity cannot recognise revenue at a point in time when access to the licence is granted to the customer, and recognise revenue over time for the performance improvements, because the promise to grant access to the licence is considered one distinct performance obligation. If it appears that the criteria for right to access and right to use the licence have been met, the entity should reconsider whether it has appropriately identified each distinct performance obligation per step 2 above.

6. Contract costs

6.1. Costs of obtaining a contract

Certain costs of obtaining a contract may be capitalised:

- Those that would not be incurred if the contract was not obtained (incremental costs), as long as they are recoverable. A sales commission is therefore capitalised, but costs of preparing or delivering a tender presentation are not
- Those which the customer has to pay for even if the contract is not awarded

Where an entity adopts an accounting policy of recognising costs that meet the capitalisation criteria above as an asset, these costs would be amortised over the period of the contract (unless the amortisation period is one year or less). Costs that do not meet the criteria above are expensed when incurred.

6.2. Costs to fulfil a contract

Such costs will normally be covered by other standards (e.g. Section 13 Inventories, Section 17 Property, plant and equipment and Section 18 Intangible assets other than goodwill). If this is not the case, such costs shall be capitalised as an asset if they

- Relate directly to a contract or anticipated contract
- Generate or enhance resources which will be used to satisfy performance obligations
- Are expected to be recovered.

Contract
balances





Example – Costs of obtaining a contract/fulfilling a contract

S&W's audit team tender for the audit of entity B and incur the following costs:

- £5,000 for preparing tender documentation
- £10,000 for interviewing entity B staff and preparing a draft audit plan for inclusion in the tender
- £5,000 for delivering a pitch to the audit committee

S&W's audit team are confident they will win the tender as the preferred bidder and the audit will be profitable.

The tender documentation and pitch costs will be written off as incurred, as these are not incremental costs and cannot be recharged to entity B.

However, preparing a draft audit plan will produce notes which would be used in the audit (for example background information and systems notes). The existence of a contract or an anticipated contract is a relatively high bar, and so when this condition is met (in conjunction to the other criteria above), the costs of preparation of the audit plan may be capitalised.

7. Contract balances

Contract balances can be an asset or liability and reflect how much an entity has either:

- Already earned but not yet billed (contract asset)
- Already been paid but not yet earned (contract liability)

A contract asset is recognised when the entity transfers goods or services to a customer before the customer pays, or before payment is due. This asset is derecognised when the customer pays and is assessed for impairment in accordance with Section 11 Basic financial instruments. A receivable is only recognised where the customer has been invoiced. A contract liability is recognised where the customer has paid in

advance, but the entity has not yet delivered goods or services.

7.1. Customer's unexercised rights

Where an entity receives an upfront non-refundable payment that gives the customer a right to receive goods or services (e.g. a gift card), a contract liability is recognised. However, if the customer does not exercise all of their contractual rights, the unexercised contractual rights are referred to as "breakage". An entity would recognise revenue from a breakage amount when the likelihood of the customer exercising its remaining rights becomes remote.

8. Presentation and disclosure

Entities are required to disclose sufficient information to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customer. Alternative terminology such as accrued revenue (for contract assets),

deferred revenue (for contract liabilities) and trade receivables (for receivables) can be used if clearly explained.

Key disclosures include the following:

Item	Detail
Disaggregation of revenue	Breakdown by product/service lines, geographical areas, market or type of customer, contract types (i.e. over time or point in time), revenue earned as agent or as a principal.
Separate disclosure required (unless on the face of the SOCI)	Revenue from contracts with customers, impairment losses related to receivables or contract asset (disclosed separately from other impairments).
Detail about contract balances	Opening/closing balances of contract assets and liabilities. Revenue is recognised that was included in a contract liability at the start of the period and changes in variable consideration.
Performance obligations - general	Information about performance obligations, including a description of when the entity satisfies performance obligations, significant payment terms, the nature of promised goods or services, any obligations such as those for returns or refunds and types of warranties.
Performance obligations – over time	Methods used to recognise performance obligations satisfied over time.
Performance obligations – unsatisfied	Quantitative or qualitative information of the significance of unsatisfied performance obligations and when they might be satisfied.
Costs to obtain/fulfil contracts	Disclose nature, amortisation and recognition of related assets.
Significant judgements	Significant judgements relating to the timing of satisfaction of the performance obligations, such as which methods are used to estimate completion.

Effective date of initial application

9. Effective date of initial application

The amendments to Section 23 are effective for periods beginning on/ after 1 January 2026.

Earlier application is permitted, provided that all periodic review amendments effective on the same date are applied together. If an earlier application date is adopted, this fact must be disclosed. Most periodic review requirements are applied retrospectively.

An entity has an accounting policy choice to apply either the full retrospective approach, or modified retrospective approach, on initial application of the revised Section 23. The modified retrospective approach entails an adjustment to the opening balance of retained earnings at the date of initial application, without the need to

restate comparative information.

This approach applies only to contracts not completed by the initial application date. Other practical expedients are available under this approach. The full retrospective approach requires restatement of comparatives, with certain simplifications and optional expedients available.



S&W observations – Initial application

Both the modified retrospective approach and fully retrospective approach require an analysis of the effect of the new revenue recognition model on the prior year end. If that impact is minimal, then entities may choose to use the modified retrospective approach and save the effort of evaluating the prior year opening balance. If the impact is significant, entities will need to consider what information would be most useful to users of the accounts.

Applying the full retrospective approach results in comparable presentation. The modified retrospective approach results may appear simpler to apply, as the prior period does not require restatement. However, an entity may not have comparable presentation with potentially revenue recognised in either both the first year of application and in the comparative or potentially in neither year. This may then need explaining to users of the financial statements.

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