IFRS 15 and IAS 18: Bill-and-hold Arrangements

Extract, IFRS Discussion Group Report on Meeting – December 3, 2015

IFRS 15 *Revenue from Contracts with Customers* replaces IAS 18 *Revenue* and IAS 11 *Construction Contracts* and is effective for annual reporting periods beginning on or after January 1, 2018.

IFRS 15 contains specific application guidance on the accounting for bill-and-hold arrangements and a non-authoritative illustrative example.

Paragraph B79 of IFRS 15 states:

> "A bill-and-hold arrangement is a contract under which an entity bills a customer for a product but the entity retains physical possession of the product until it is transferred to the customer at a point in time in the future. For example, a customer may request an entity to enter into such a contract because of the customer's lack of available space for the product or because of delays in the customer's production schedules."

Paragraphs B80 to B82 of IFRS 15 require that an entity determine when it has satisfied its performance obligation to transfer the product and sets out the criteria that must be met in order for an entity to recognize revenue for the sale of a product on a bill-and-hold basis. An entity is also required to allocate a portion of the transaction price to each performance obligation.

IAS 18 differed from IFRS 15 in that it did not contain specific guidance on bill-and-hold arrangements, but there was an illustrative example in IAS 18 that provides non-authoritative guidance.

Fact Pattern:

- A customer has requested an entity to provide custodial services. The goods are not specifically customized for the customer, but are stored in a special storage room. The entity typically does not provide custodial services unless a customer has ordered goods.
- The contract does not state a price relating to the custodial services and the total transaction price does not change regardless of how long the goods are stored at the entity's premise.
- The storage room is locked and equipped with cameras and alarms and only certain designated employees have access to the room. The entity's policy is that once goods are placed in the storage room, they are "reserved" for the specific customer and, thus, cannot be used or directed to another customer. However, the goods in the storage room are not specifically identified as belonging to a particular customer. There are controls in place to ensure compliance with the entity's "reservation" policy.
- Upon pick up of the goods, a designated employee tracks the customer purchase order in the system and identifies the specific items pertaining to the customer's order by the product description. The employee then enters the storage room, locates the described goods and provides them to the customer.

- Although the items are not specifically identified for the customer who has requested the custodial service, the total inventory count of a specific item would agree to the total quantity in the system.

The Group discussed the following three issues together in relation to the fact pattern:

Issue 1: Is the custodial service a separate performance obligation?

Paragraphs 22 to 30 of IFRS 15 contain the guidance for identifying performance obligations.

View A – Yes, the custodial service is considered a separate performance obligation.

Proponents of this view think that the custodial service is a separate performance obligation under IFRS 15 because there are economic benefits generated in the form of cost savings for storage space for the customer. The custodial service can be separately identified from the other promises in the contract since the customer specifically requested the entity to provide this service. Other goods and services delivered through the contract are not affected by the custodial service. Therefore, the service is not considered dependent or interrelated with the other goods or services in the contract.

View B – No, the custodial service is not considered a separate performance obligation.

Proponents of this view think that the customer cannot benefit from the custodial service without having ordered the goods being stored. Thus, the custodial service is highly dependent and interrelated with the goods ordered in the contract. Also, the entity does not provide custodial services unless a customer has ordered goods. This fact suggests that the service is not distinct from other promises in the contract.

Issue 2: Assuming the custodial service is considered a separate performance obligation under IFRS 15, how should the transaction price be allocated to the custodial service?

Paragraph 73 of IFRS 15 states, in part, that the allocation objective is to allocate "an amount that depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised goods or services to the customer."

Paragraph 74 of IFRS 15 states, in part, that "an entity shall allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis."

Paragraphs 76 to 80 of IFRS 15 set out the guidance for allocating the transaction price based on a stand-alone selling price. These paragraphs discuss how the best evidence of a stand-alone selling price is an observable selling price and what the suitable methods are for estimating the stand-alone selling price if the price is not directly observable. Paragraph 79 of IFRS 15 provides guidance on the suitable methods for estimating the stand-alone selling price of a good or service (i.e., the adjusted market assessment approach, expected cost plus a margin approach, and the residual approach).

Issue 3: Given the goods are not customized for the customer and how the entity stores the goods in the fact pattern, would the entity be able to recognize revenue based on the criteria outlined in paragraph B81 of IFRS 15?

The bill-and-hold criteria included in paragraph B81 of IFRS 15 are more detailed than the criteria in the illustrative example in paragraph IE1 of IAS 18.

Paragraph B81 of IFRS 15 states:

> "In addition to applying the requirements in paragraph 38, for a customer to have obtained control of a product in a bill-and-hold arrangement, all of the following criteria must be met:
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> (a) the reason for the bill-and-hold arrangement must be substantive (for example, the customer has requested the arrangement);
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> (b) the product must be identified separately as belonging to the customer;
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> (c) the product currently must be ready for physical transfer to the customer; and
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> (d) the entity cannot have the ability to use the product or to direct it to another customer."

Paragraph IE1 of IAS 18 stated:

> *"'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing.*
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> Revenue is recognised when the buyer takes title, provided:
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> (a) it is probable that delivery will be made;
>
> (b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
>
> (c) the buyer specifically acknowledges the deferred delivery instructions; and
>
> (d) the usual payment terms apply.
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> Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery."

In particular, instead of being "identified and ready for delivery" as per paragraph IE1(b) of IAS 18, the goods must be "identified separately as belonging to the customer" and the entity "cannot have the ability to use the product or to direct it to another customer" according to criteria (b) and (d) in paragraph B81 of IFRS 15. In this fact pattern, since the goods are not customized for the customer, applying the guidance in IFRS 15 may be more complex.

The Group's Discussion

With respect to Issue 1, Group members supported that the custodial service is considered a separate performance obligation (View A) and observed that the proposals in the IASB's Exposure Draft, "Clarifications to IFRS 15," would further support this view.

In considering the approach to take in allocating the transaction price (Issue 2), Group members expressed that it would be difficult to rule out any of the approaches outlined in paragraph 79 of IFRS 15. The adjusted market assessment approach would seem more common because it would be unusual for an entity to not be able to obtain some element of observable input with respect to the price of storage in the market. Paragraph 78 of IFRS 15 requires an entity to maximize the use of observable inputs in estimating the transaction price. One Group member observed that if an entity concludes that the expected cost plus margin associated with providing the custodial service is immaterial, sufficient support is needed because such an approach would result in full revenue recognition upfront and be inconsistent with the concept of using maximizing observable inputs. Therefore, considering the transaction price of the custodial services to be immaterial should not be viewed as a default position. Other approaches permitted under IFRS 15 may be more appropriate.

The Group also discussed how an entity would measure the progress towards complete satisfaction in this fact pattern. One Group member noted that management would make its best estimate of how long the goods would be stored for and use that estimate as a basis for measurement to completion. Another Group member commented that if a high level of uncertainty exists around what the custodial period is, this could suggest that revenue cannot be reliably measured.

With respect to Issue 3, Group members noted that since the goods are not tagged specifically for a particular customer in the fact pattern described, it would be difficult to satisfy the bill-and-hold criteria despite being segregated from other inventory. A customer would not be able to insure its goods if not distinctly identified. Group members thought that the criterion of an entity not being able to use the product or direct it to another customer in paragraph B81(d) of IFRS 15 presents a very high hurdle. Simply tagging and segregating the goods may not be sufficient if the ability to substitute still exists. Highly customized goods would help limit the ability to interchange products. For identical goods, it would be more difficult to satisfy this criterion. However, one Group member noted that if unique serial numbers were used and also specified in the contractual arrangement with the customer, this may help limit the ability to substitute the goods. If an independent security service was used to secure the specified good, this may also constrain the entity's ability to use or direct it to another customer. It was noted that the criterion in paragraph B81(d) of IFRS 15 is similar to the guidance of the U.S. Securities and Exchange Commission.

Overall, the Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).