DOWNLOAD PDF CONTRACT PERFORMANCE AND EXPLOITATION OBLIGATIONS

Chapter 1 : Performance of Contract | Meaning | Types of Performance

The Performance of Obligations clause is a condition to close a transaction. The clause may be used where there is a period of time between the agreement and the consummation of the bargain, such as may occur in purchase and finance transactions.

Identify the contract with a customer. Revenue for these partially completed performance obligations cannot be recognized until the contract is established. There is some debate about how revenue in these situations should be recognized. This article outlines two potential revenue recognition patterns for partially satisfied performance obligations at contract inception and demonstrates how revenue would be recognized under the method we believe is most appropriate. The article also discusses how to account for the costs resulting from activities performed prior to contract inception that relate to the transfer of a good or service to a customer. Administrative activities that do not result in transferring control of goods or services to a customer or fulfilling the anticipated contract Activities, such as set-up costs, to fulfill an anticipated contract that do not result in transferring control of goods or services to the customer Activities that transfer control of goods or services to a customer at or subsequent to the CED The first two types of activities do not transfer goods or services to a customer and should not have any revenue allocated to them. This article deals with the accounting treatment for the third type of pre-CED activities. Example 1- Contract Manufacturer A manufacturer enters into a long-term contract with a customer to manufacture a highly customized good. The customer issues purchase orders for 30 days of supply on a rolling calendar basis that is, every 30 days a new purchase order is issued. Purchase orders are non-cancellable and the manufacturer has a contractual right to payment for all work in process for goods once an order is received. The manufacturer will pre-assemble some goods in order to meet the anticipated demand from the customer based on a non-binding forecast provided by the customer. At the time the customer issues a purchase order, the manufacturer has some goods on hand that are completed and others that are partially completed. The entity has determined that each customized good represents a performance obligation satisfied over time because the customized goods have no alternative use and the manufacturer has an enforceable right to payment once it receives the purchase order Accounting Standards Codification ASC c. In this particular territory, the contracts satisfy the criteria for a performance obligation satisfied over time in accordance with ASC c. After construction of the common areas and the shells of all the rooms have been completed, the entity enters into a new contract with a customer to sell one of the remaining units on the same terms as the original contracts. The preferred method of revenue recognition includes a cumulative catch-up adjustment in which the entity recognizes revenue for the portion of the good or service which has been transferred to the customer. In the first example, this is the inventory that has been created in anticipation of the contract. In the second example, it is the percentage of the contracted-for apartment that is completed at the CED. In the Real Estate Developer example, after the catch-up adjustment, the amount of revenue recognized for the new contract would be the same percentage of total revenue as the original contracts. The treatment of the costs incurred to perform these pre-CED activities that transfer a good or service to the customer is another issue resulting from such situations. The method we believe to be the most preferred is to capitalize such costs as costs to fulfill an anticipated contract. The costs are then immediately expensed at the CED if they relate to performance obligations that have been transferred to the customer. This would be the case in both of the examples given above. In the memo that addressed this topic, two issues were presented and discussed. How should revenue arising from pre-CED activities be recognized? How should an entity account for fulfillment costs incurred prior to the CED? Issue 1 View A. This view supports the cumulative catch-up method as outlined above. The cumulative catch-up method reflects that, as of the CED, control of some of the goods or services has already passed to the customer. This view states that an entity should recognize revenue on a prospective basis. An entity should begin measuring progress toward completion of performance obligations only after the CED, ignoring pre-CED activities performed. They believe a catch-up adjustment is inconsistent with recognizing revenue over time. View B does not depict the transfer of control as accurately as View A. Additionally, we do not believe that a catch-up adjustment is inconsistent with recognizing revenue over time. In the examples above, a portion of the goods or services are transferred to the customer at the CED, while the rest is transferred over time. Consequently, the recognition of revenue should depict some immediate transfer and the rest over time. Issue 2 View A. Costs are capitalized as costs to fulfill an anticipated contract. These costs are immediately expensed at the CED if they relate to goods or services already transferred to the customer. Any remaining asset is amortized over the period over which the goods or services to which the asset relates are transferred to the customer e. Proponents of this view point to ASC , which states that an entity will recognize costs to fulfill a contract as an expense when incurred if they relate to satisfied or partially-satisfied performance obligations. Because a performance obligation is not created until the CED, no costs should be expensed until then. Consequently, if some of the goods or services are transferred at the CED, the related capitalized costs should be expensed at the same time. Costs are capitalized as costs to fulfill an anticipated contract, and amortized as the entity transfers the remaining goods or services under the contract. This view is coupled with View B of Issue 1 because costs are amortized on a prospective basis. Proponents of View B argue a performance obligation can only comprise remaining activities after the CED, in other words, there is no immediate transfer at the CED. Costs cannot be capitalized as costs to fulfill an anticipated contract because they relate to progress made prior to obtaining the contract and not to satisfying performance obligations in the future. Such costs should be expensed as incurred unless they qualify for capitalization under other guidance for example, inventory. Proponents of this view believe that such costs would likely not qualify for capitalization because the costs will not be used to satisfy performance obligations in the future as is required in ASC b. They believe the costs do no relate to future performance and therefore should be expensed immediately. Most members of the TRG concluded that View A under both issues represents the most appropriate accounting. The determining factor between the views is whether or not the performance obligations within a contract where the 3rd type of pre-CED activities occur are the same as in an identical contract where no pre-CED activities have occurred. If there is no difference in the performance obligations, then View A is most appropriate. However, proponents of View B say that the performance obligations do change and that the performance obligations in the contract are only made up of work that is remaining. Our view is that the performance of pre-CED activities do not change the performance obligation of the contract and that the cumulative catch-up method is appropriate. Comparison to Under , it is unclear how companies are accounting for this type of situation. Based on our analysis, it seems very reasonable that a company could reach the conclusion that a cumulative catch-up as part of the percentage-of-completion method is most appropriate. Persuasive evidence of an arrangement Delivery has occurred or services are rendered Price is fixed or determinable Collectability is assured The primary issue in this analysis is determining whether delivery has occurred. If the arrangement qualified for recognition over time, this requirement is met for the portion of the goods or services already completed. However, there could be circumstances where other conclusions are reached under Below are two examples from comment letters to the SEC describing how similar situations are accounted for. In these instances, we do not recognize revenue under the percentage of completion method. Rather, we will build up the inventory balance as the equipment is constructed and revenue is recognized at the time title passes to the customer. For these contracts, revenue is recognized using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. Estimates of costs to complete include material, direct labor, overhead, and allowable indirect expenses for our government contracts. These cost estimates are reviewed and, if necessary, revised monthly on a contract-by-contract basis. If, as a result of this review, we determine that a loss on a contract is probable, then the full amount of estimated loss is charged to operations in the period it is determined that it is probable a loss will be realized from the full performance of the contract. The first company recognizes the revenue as title passes. The second company arrives at a similar answer by deferring those costs and then including them in the percentage of completion calculation after the CED. The company accurately measures progress made to date by including the costs incurred prior to the CED in both the total estimated costs and costs incurred to date, leading to recognition of the revenue related to those costs. Summary When companies have partially-completed performance obligations at the CED, a cumulative catch-up adjustment for the completed portion followed by ratable recognition for the remaining portion may be the most appropriate accounting treatment. Although other views have been expressed to the Boards, most TRG members agree that a cumulative catch-up is appropriate.

DOWNLOAD PDF CONTRACT PERFORMANCE AND EXPLOITATION OBLIGATIONS

Chapter 2 : Performance & Breach of Contracts | racedaydvl.com

Things to Consider. Performance obligations are the goods and services that are provided to a customer in a revenue contract. In some cases, multiple goods and services are bundled to create a distinct bundle of goods or services which represent a performance obligation.

Contract obligations are those duties that each party is legally responsible for in a contract agreement. In a contract, each party exchanges something of value, whether it be a product, services, money, etc. On both sides of the agreement, each party has various obligations in connected with this exchange. An example of contract obligations is with the sale of a product such as an automobile. One party has the obligation to transfer ownership of the car, while the other has the obligation to pay for it. If either party fails to perform their contractual obligations according to the contract terms, it will usually result in a breach of contract. This may result in a damages award to reimburse the non-breaching party for their economic losses. As mentioned, contract obligations generally depend on the specific subject matter of the contract. Contract obligations for a sales contract may be much different than other types of contracts, such as a rental agreement contract. However, most legal agreements contain some of the same types of contract obligations, such as: One party the buyer is usually legally bound to provide payment for the sale of goods or services. The contract terms may state obligations regarding payment amounts and the deadline for payment. The seller is usually bound to provide delivery of the goods or services. Again, the contract may state specific obligations in terms of delivery dates, method of delivery and other terms. The seller may also be bound to provide goods of a certain quality. This may be specifically described in the contract These types of obligations can vary according to the individual details of the contract. In addition to these specific obligations, each party in a contract is also bound by certain general principles and obligations when forming the contract. For instance, each party is obligated to deal fairly and truthfully with the other party, and each party is also obligated to refrain from using force or coercion in obtaining the agreement. In some cases, contract obligations can be transferred to a third party. Contract delegation may or may not be allowed for all obligations; the ability to delegate a contract duty may depend on the type of obligation as well as state contract laws. Do I Need a Lawyer? Contract obligations will be different in each individual claim. You may need to contact an experienced contracts attorney if you have any disputes or legal questions about a contract obligation. Your lawyer can provide you with legal research and guidance to address your inquiries about contract obligations. In addition, if you need to file a lawsuit for a violation of contract obligations, your attorney can provide you with assistance and representation in court.

Chapter 3 : Case Study: Transaction Price Allocation | RevenueHub

Identifying performance obligations is the second step of the revenue model. In this video I'll define what a performance obligation is, the criteria for determining when goods or services in a contract should be accounted for separately or as a group, and I'll share an example of applying the guidance.

The first alternative would account for a good or service, or a bundle of goods or services, as a separate performance obligation if 1 the good or service is distinct and 2 the good or service has a different pattern of transfer to the customer. This alternative would provide a list of indicators of when a good or service may be distinct including 1 the entity regularly sells the good or service separately, 2 the customer can use the good or service either on its own or together with resources that are readily available to the customer, 3 the entity and the customer negotiated the sale of goods or services separately, or the entity is not providing a significant service of integrating the promised goods or services into a single item that the entity provides to the customer. The second alternative would account for a good or service, or a bundle of goods or services, as a separate performance obligation if 1 the good or service has a different pattern of transfer to the customer and 2 the customer can use the good or service either on its own or together with resources that are readily available to the customer. However, one would account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating those goods or services into a single item that the entity provides to the customer. The Boards generally viewed the two alternatives as more favourable to the original staff proposals only one FASB member expressed support for the original staff proposals. However, several members from each Board preferred certain aspects from each of the models rather than one model in its entirety. Specifically mentioned was the overriding requirement from the second alternative that one would account for a bundle of promised goods or services as one performance obligation if the entity provides a service of integrating those goods or services into a single item that the entity provides to the customer rather than having a similar criteria as only an indicator in the first alternative. However, there was support for the first alternative because it incorporated the concept of distinct which many felt preparers could understand and apply. The Boards tentatively agreed to incorporate aspects of both alternatives into the model for identifying a separate performance obligation. The model would first consider if the entity provides a service of integrating a bundle of goods or services into a single item that the entity provides to the customer. If so, the entity would account for the bundle as a single performance obligation. If not, the entity would account for a promised good or service as a separate performance obligation if 1 the good or service is distinct and 2 the good or service has a different pattern of transfer to the customer. The model would also include indicators of what would be considered distinct, including 1 the entity regularly sells the good or service separately, 2 the customer can use the good or service either on its own or together with resources that are readily available to the customer, and 3 the entity is not providing a significant service of integrating the promised goods or services into a single item that the entity provides to the customer. Existence of a contract and definition of a performance obligation The revenue recognition exposure draft defined a performance obligation as "an enforceable promise whether explicit or implicit in a contract with a customer to transfer a good or service to the customer". The Boards tentatively agreed to remove the term enforceable from the definition of a performance obligation to provide clarity that other non-contractual arrangements could be identified as performance obligations. Breakage on prepayments The Boards also discussed the topic of breakage on prepayments i. The revenue recognition exposure draft provided that an entity would recognise a contract liability upon receipt of any prepayment from a customer for its performance obligation to provide goods or services in the future and derecognise the liability and recognise revenue when the good or service is transferred. While, the exposure draft did not specifically address how to recognise revenue for breakage on prepayment, the staffs believe the accounting is similar to the proposals for contract options for additional goods or services. Under those proposals, an option is accounted for a separate performance obligation only if the option provides the customer with a material right that the customer would not receive without entering into that contract. If the option provided a material right, then the entity recognises revenue when it transfers those future goods or services or when the option expires. The exposure draft also included an example example 26 that illustrated the guidance in the context of a customer loyalty programme and how an entity would recognise revenue based on a pattern of redemption of the loyalty points. The staffs proposed that revenue for breakage should be recognised in proportion to the pattern of rights being exercised by the customer the proportional model , but if an entity cannot reasonably estimate breakage then revenue should be recognised when the likelihood of the customer exercising their right becomes remote the remote model. The staffs believe this is consistent with the guidance on options already included in the exposure draft. Some preferred only permitting the remote method while others preferred recognising immediately if an amount can be reasonably estimated and utilising the remote method when an estimate cannot be reasonably estimated. The staffs reiterated their position that the proposal is consistent with the Boards position on the accounting for options. The IASB tentatively agreed with 10 Board members supporting the proposal for the proportional method when a pattern can be estimated but the remote model in other instances. The FASB did not reach a majority supporting the proposal 2 votes but 4 Board members agreed "not to object". Onerous performance obligations The Boards also began discussions on onerous performance obligations. Because of time limitations, the Boards were only able to address the first topic of whether the onerous test should be performed at the contract of performance obligation level. The Boards were not able to discuss the topics of whether subsequent contracts should be linked in determining whether to recognise an onerous liability and what costs should be included in the onerous test. Both of these issues will be addressed at a future joint board meeting. The revenue recognition exposure draft proposed that an onerous liability be recognised when the present value of the probability weighted costs that relate directly to satisfying that performance obligation exceeds the amount of the transaction price allocated to that performance obligation. The Boards proposed that the onerous test be performed at the performance obligation level in order to provide transparency for margins on each performance obligation and to provide timely information by recognising changes in circumstances impacting a performance obligation at the time it becomes loss-making. Almost all comment letter respondents who commented on the onerous test opposed the proposals in the exposure draft that the test be performed at the performance obligation level. They cited various reasons for performing the test at a higher level unit of account than the performance obligation, including that items are often not priced at the performance obligation level, it is misleading to recognise a loss on a part of the contract when the overall contract is profitable, and that costs are not necessarily tracked at the performance obligation level which would make the test difficult to apply. The staffs believe that some of these issues may be addressed through other changes to the revenue recognition proposals currently under discussion. However, they also acknowledged the issues identified by comment letter respondents. The staffs proposed that the onerous test be performed at the contract level and clarify that would be the remaining performance obligations in the contract. A few members from each Board opposed the staff recommendation but the majority of both Boards seemed supportive of the proposals. One IASB member asked the staff what disclosures were planned to supplement the decision to apply the onerous test at the contract level. The staff responded that the exposure draft included disclosures for onerous contracts but that all disclosures would be reassessed as part of the current discussions. The Boards tentatively decided that the onerous test would be performed at the contract level rather than the performance obligation level as was proposed in the exposure draft twelve IASB members and three FASB members supported the decision.

Chapter 4 : Accounting for revenue â€“ identifying the performance obligations | John Hughes IFRS Blog

The term ' Performance of contract ' means that both, the promisor, and the promisee have fulfilled their respective obligations, which the contract placed upon them. For instance, A visits a stationery shop to buy a calculator.

Attempted Performance Introduction A contract places a legal obligation upon the contracting parties to perform their mutual promises, and it carries on until the discharge or termination of the contract. The most natural and usual mode of discharging a contract is to perform it. A person who performs a contract in accordance with its terms is discharged from any further obligations. Exact and complete performance by both the parties puts an end to the contract. In expecting exact performance, the courts mean that, performance must match contractual obligations. In requiring a contract to be complete, the law is merely saying that any work undertaken must be carried out to the end of the obligations. A contract should be performed at the time specified and at the place agreed upon. When this has been accomplished, the parties are discharged automatically and the contract is discharged eventually. There are, however, many other ways in which a discharge may be brought about. For example, it may result from an excuse for non-performance. In certain cases attempted performance may also operate as a substitute for actual performance, and can result in complete discharge of the contract. Performance of contract and types What is Performance of Contract? For instance, A visits a stationery shop to buy a calculator. The shopkeeper delivers the calculator and A pays the price. The contract is said to have been discharged by mutual performance. Section 27 of Indian contract Act says that The parties to a contract must either perform, or offer to perform, their respective promises, unless such performance is dispensed with or excused under the provisions of this Act, or any other law. Promises bind the representatives of the promisor in case of the death of the latter before performance, unless a contrary intention appears in the contract. Thus, it is the primary duty of each contracting party to either perform or offer to perform its promise. For performance to be effective, the courts expect it to be exact and complete, i. However, where under the provisions of the Contract Act or any other law, the performance can be dispensed with or excused, a party is absolved from such a responsibility. Example A promises to deliver goods to B on a certain day on payment of Rs 1, A expires before the contracted date. Types of Performance Performance, as an action of the performing may be actual or attempted. Actual Performance When a promisor to a contract has fulfilled his obligation in accordance with the terms of the contract, the promise is said to have been actually performed. Actual performance gives a discharge to the contract and the liability of the promisor ceases to exist. A delivers the cement on the due date and B makes the payment. This is actual performance. Actual performance can further be subdivided into substantial performance, and partial Performance Substantial Performance This is where the work agreed upon is almost finished. The court then orders that the money must be paid, but deducts the amount needed to correct minor existing defect. Substantial performance is applicable only if the contract is not an entire contract and is severable. The rationale behind creating the doctrine of substantial performance is to avoid the possibility of one party evading his liabilities by claiming that the contract has not been completely performed. However, what is deemed to be substantial performance is a question of fact to be decided in both the case. It will largely depend on what remains undone and its value in comparison to the contract as a whole. Partial Performance This is where one of the parties has performed the contract, but not completely, and the other side has shown willingness to accept the part performed. Partial performance may occur where there is shortfall on delivery of goods or where a service is not fully carried out. There is a thin line of difference between substantial and partial performance. The two following points would help in distinguishing the two types of performance. Partial performance must be accepted by the other party. In other words, the party who is at the receiving end of the partial performance has a genuine choice whether to accept or reject. Substantial performance, on the other hand, is legally enforceable against the other party. Payment is made on a different basis from that for substantial performance. It is made on quantum meruit, which literally means as much as is deserved. So, for example, if half of the work has been completed, half of the negotiated money would be payable. In case of substantial performance, the party that has performed can recover the amount appropriate to what has been done under the contract, provided that the contract is not an entire contract. The price is thus, often payable in such circumstances, and the sum deducted represents the cost of repairing defective workmanship. Attempted Performance When the performance has become due, it is sometimes sufficient if the promisor offers to perform his obligation under the contract. This offer is known as attempted performance or more commonly as tender. Thus, tender is an offer of performance, which of course, complies with the terms of the contract. If goods are tendered by the seller but refused by the buyer, the seller is discharged from further liability, given that the goods are in accordance with the contract as to quantity and quality, and he may sue the buyer for. The rationale being that when a person offers to perform, he is ready, willing and capable to perform. Accordingly, a tender of performance may operate as a substitute for actual performance, and can effect a complete discharge. In this regard, Section 38 of Indian Contract Act says: For example, A contracts to deliver to B, tons of basmati rice at his warehouse, on 6 December Here, A has performed what he was required to perform under the contract. It is a case of attempted performance and A is not responsible for non-performance of B, nor does he thereby lose his rights under the contract.

DOWNLOAD PDF CONTRACT PERFORMANCE AND EXPLOITATION OBLIGATIONS

Chapter 5 : Contract Obligations | LegalMatch Law Library

Identification of Performance Obligations Â· An entity shall evaluate the terms of the contract and its customary business practice to identify all promised goods or services and determine whether to account for each promised good or service as a separate performance obligation.

In our first installment , we discussed the initial stage, which is identifying the contract s with the customer. The second step is identifying the performance obligations in the contract. Contracts may have multiple performance obligations, with those meeting the following two criteria recognizing revenue separately: The good or service is capable of being distinct, meaning that a customer can benefit from the good or service on its own, or together with other resources readily available to the customer. The good or service is distinct within the context of the contract, meaning the good or service is separately identifiable from other promises in the contract. While it is not uncommon for a contract to contain a single clear performance obligation, such as a retailer selling a single product to a consumer, or wholesale and manufacturing companies delivering a specified product to a customer, there may be additional performance obligations not previously considered. For example, many entities have loyalty reward programs which may create additional performance obligations. When an individual picks up their morning bagel, and he or she uses a punch card allowing for a free bagel after purchasing five bagels, the entity may have a performance obligation to provide the sixth bagel for free. Each of those future oil changes represents a future performance obligation. Performance obligations may become increasingly difficult to identify when multiple components or stages are not clearly articulated within a contract, or do not provide separate individual benefit to a customer. If performance obligations are not clearly defined, revenue may not be recognized until all aspects of the contract are fully satisfied. Identifying performance obligations is particularly essential to industries that currently use a percentage-of-completion or some other recognition method for which revenue is recognized over time or phases. For example, a construction contractor enters into a contract to build a home. The contractor is responsible for design, site clearing, foundation, and construction of the home, and the contract only specifies an obligation for the delivery of the agreed-upon home. While the building materials used in the construction meet the first criterion they are distinct and can be used on their own , the contract did not identify separate phases of the construction project. Accordingly, one promise of delivery is not separately identifiable from another. Therefore, the contractor will likely consider the contract to include a single performance obligation. The separate maintenance service meets both criteria of a performance obligation; therefore, it will be considered a separate performance obligation for which revenue would be separately allocated and recognized. Many industries, as well as entities within certain industries, have deliverable arrangements that are difficult to separately identify. All entities should take great care to identify all their explicit or implicit performance obligations. Questions about this process? Contact your Eide Bailly representative today. Catch up on this series!

Chapter 6 : Revenue recognition

12 Definition of Performance Obligation â€¢ Refresh on the definition of a Performance Obligation (PO) -A Promise in a contract to deliver to a customer.

After the standalone selling price has been estimated for each performance obligation in the contract, the transaction price is generally allocated to each performance obligation using the relative standalone selling price method, except for cases involving variable consideration and discounts, and when the residual approach is utilized. The purpose of this article is to illustrate the process of allocating the transaction price through a comprehensive example. The following key accounting issues are addressed in this article: How does variable consideration in a contract impact the transaction price allocated to each performance obligation? When should the guidance on allocating discounts be applied? How do discounts in a contract impact the transaction price allocated to each performance obligation? How is the relative standalone selling price method applied to allocate the transaction price? The accounting principles involved in this example are discussed at length in the following articles: On January 1, MFE enters into a contract with a customer to sell the following items: The standalone selling prices for the items in the contract are as follows: The combine, harvesting heads, and cover are delivered on January 1 and the post-contract support starts on that date. The GPS system is delivered and installed on January Considering these facts, how should MFE allocate the transaction price? Accounting Analysis The transaction price should be allocated to the performance obligations using the relative standalone selling price method. However, when specific criteria are met, variable consideration and discounts are allocated to one or more, but not all of the performance obligations. The basic overall objective is that the allocation reflects the expected consideration for each item performance obligation in the contract rather than the contract as a whole. In situations where variable consideration and discounts are present and the residual approach is used, the transaction price should be allocated using the following steps in order: While normal transactions rarely require all four steps, we will consider each step using the hypothetical situation above for illustration purposes. Variable Consideration Variable consideration is considered first when allocating the transaction price. The terms of the variable discount are specifically related to the outcome of satisfying the performance obligation to transfer the machinery. The first criterion is not met since the five percent discount is not specifically related to the performance obligation of the company, which is to transfer the machinery. Rather, the variable discount is related to the performance obligation of the customer, which is to pay for half of the list price within thirty days. Since one of the criteria is not met, the guidance on discounts is taken into consideration to determine if the variable discount may be allocated to one or more, but not all of the performance obligations. In this memo, the TRG clarified that variable discounts are first subject to the criteria under the variable consideration guidance. If those criteria are not met, the variable discount is then subject to criteria under the discount guidance. All of the goods or services are regularly sold on a stand-alone basis. The company regularly sells the good combine at a discount. The normal discount for the good combine is substantially the same as the overall discount offered in the contract. Since the criteria are met, the variable discount is applied entirely to the combine when allocating the transaction price. The company regularly sells the bundle of the performance-enhancing items at a discount. Since the criteria are met, the second discount is applied entirely to the GPS system and harvesting heads using the relative standalone selling price method as follows: Residual Approach The residual approach was not utilized to determine the standalone selling price of any of the items. The residual approach is used only when the entity sells the same good to different customers for a broad range of prices. Relative Standalone Selling Price Method After accounting for the variable consideration, discounts, and residual approach, the remaining transaction price is allocated to the final performance obligations in the contract using the relative standalone selling price method. Transaction Summary The transaction price should be allocated to the performance obligations using the relative standalone selling price method. However, since the contract contains variable consideration and fixed discounts, the transaction price is allocated to the performance obligations using these steps in the following order: Since the criteria for specifically allocating variable consideration are not met, the variable discount is passed through to the guidance on allocating discounts. After meeting the criteria for allocating discounts, the variable discount is allocated entirely to the combine. The criteria for specifically allocating discounts are also met for the fixed discount and it is allocated between the harvesting heads and GPS system according to their standalone selling prices. Since the residual method was not used, the remaining transaction price is allocated between the cover and the post-contract support according to the relative standalone selling price method. A summary of the allocated transaction price is shown in the table below. Comparison to The new revenue standard differs in many ways from ASC This article touches on multiple changes that have been made in different areas of the new standard. The following sections explore these differences by topic. Variable Consideration Under ASC , variable consideration was not estimated or allocated to the transaction price. Consideration had to be fixed and determinable to be recognized as revenue or considered as part of the standalone selling price. In certain situations, these modifications will change the timing and amount of revenue recognized, but the results of this example would be similar under both ASC and Discounts Theoretically, under ASC discounts could not be attributed to one or more, but not all of the performance obligations except in the software industry when the residual method was used, and the discount had to be allocated to only the delivered performance obligations. In practice, the guidance was ignored and discounts were generally allocated entirely to the performance obligation to which they pertained. ASC explicitly allows discounts to be allocated to one or more, but not all of the performance obligations and to be attributed to both delivered and undelivered items in the contract regardless of the industry or circumstance. Conclusion This article discusses the process of allocating the transaction price to performance obligations in the contract when variable consideration and fixed discounts are present. It provides a comprehensive example of how to allocate variable consideration variable discounts and fixed discounts before applying the relative standalone selling price method. The results of the transaction are very similar under ASC and , but the guidance in ASC explicitly allows discounts to be allocated to one or more, but not all of the performance obligations regardless of whether those items are delivered or undelivered.

Chapter 7 : Performance of Obligations

However, performance obligations don't include other activities necessary to fulfilling a contract that don't transfer a good or service to a customer. For example, the standard specifies that "various administrative tasks to set up a contract" don't constitute a performance obligation if the customer doesn't directly receive a.

When a party is accused of failing to perform under a contract they may respond that they have not breached the contract because any performance they were to render was conditional, i. Dependent or Independent Promises? There is a presumption that mutual promises in a contract are dependent. Promises are dependent if the parties intend performance by one to be conditioned upon performance by the other. There is a strong presumption that a promise in a contract is not intended to be an independent promise unless a contrary intention is clearly manifested. Although neither party expressly conditions his promise on performance by the other, the law constructs a condition that performance or tender of performance, by one party is a condition precedent to the liability of the other party. Conditions; Express or Constructive? An express condition is one placed in the contract by the parties. A constructive condition sometimes called an implied condition is one imposed by law in order to do justice. Express conditions must be literally performed. Constructive conditions may be satisfied by substantial performance. Iron Trade Products v. Waiver and Estoppel Where one party has indicated by words or conduct that he will not require a condition to be satisfied, and the other party materially changes his position in reliance, the first party is estopped from insisting that the condition be satisfied. Thus, waiver, the voluntary relinquishment of a known right, may give rise to an estoppel, if the other party changes their position to their detriment in reliance on the waiver. Restitution for a Party in Default A defaulting party who has not substantially performed may nevertheless be entitled to restitution as a means of avoiding unjust enrichment. A defaulting plaintiff, although unable to recover on the contract, may recover under a theory of quasi contract for the reasonable value of his services less any damages suffered by defendant. The general understanding of the community is that payment should be made for services actually rendered. A party in default is not necessarily deprived of all relief. Actual and Anticipatory Breach An unjustified or unexcused repudiation of or failure to perform a contract at the time performance is due is an actual breach. A repudiation which occurs before the time when performance is due is an anticipatory breach. See, Franconia Associates v. On a contract to do an act on a future day, a renunciation by one party dispenses with a condition to be performed in the meantime by the other party. There is no reason for requiring the other party to wait until performance is due before seeking his remedy. De La Tour 2 E. An express repudiation must be clear, positive and unequivocal in order to have the effect of an anticipatory breach. The doctrine of anticipatory breach has no application to money contracts where one party has fully performed and all that remains for the opposite party to do is to pay a certain sum of money at certain times. The rationale is that the aggrieved party has already fully performed and would not be harmed by awaiting counterperformance at the time promised. An anticipatory breach will also result from an implied repudiation, where the promisor puts it out of his power to perform. A repudiation may be retracted before a change of position in reliance thereon. It is too late to retract a repudiation after the injured party changes position. All that is required to close the door to retraction is definite action indicating that the anticipatory breach has been accepted as final. Waiver of Breach Instead of treating a breach as a termination of the contract, the injured party may waive the breach by electing to treat the contract as still alive, and remaining ready and able to perform on his or her own part, thereby limiting the claim to damages caused by the breach. See, UCC 3 a. Damages The measure of damages for nondelivery or repudiation by the seller is the difference between the market price at the time when the buyer learned of the breach and the contract price together with an incidental and consequential damages. The aggrieved party may await performance for a commercially reasonable time before resorting to his remedies of cover or damages. Right to Assurance of Due Performance Where a party to a contract is guilty of serious prospective inability or unwillingness to perform, the other party may make a demand for "adequate assurances of due performance.

Some jurisdictions have extended the doctrine to contracts of all types, not just those for the sale of "goods. Niagara Mohawk Power Corp. Perfect Tender Rule At common law, a buyer of goods possessed a legal right to insist upon "perfect tender" by the seller. This rule has been retained by the UCC. In a contract for the sale of goods, if the goods fail to conform exactly to the description in the contract whether as to quality, quantity or manner of delivery the buyer may reject the goods and rescind the contract.

DOWNLOAD PDF CONTRACT PERFORMANCE AND EXPLOITATION OBLIGATIONS

Chapter 8 : Revenue Recognition â€“ Step 2: Identify the Performance Obligation in the Contract

While it is not uncommon for a contract to contain a single clear performance obligation, such as a retailer selling a single product to a consumer, or wholesale and manufacturing companies delivering a specified product to a customer, there may be additional performance obligations not previously considered.

In the previous installments to this series, we have discussed the first three steps: Identify the contract s with a customer. Identify the performance obligations in the contract. Determine the transaction price. Leading up to step four, an entity will have identified all the performance obligations and determined the overall transaction price. While it may seem simple on the surface to then apply the overall transaction price to the various performance obligations, in many cases the determination of the value of each performance obligation may be difficult. The most common allocation method is to determine the standalone selling price of each performance obligation. For example, if the purchase of a new car comes with two years of oil changes, the standalone price of the oil changes would be relatively easy to value as this is a service that is separately provided to other customers with a determinable price. However, not all performance obligations are as easy to separate. If the goods or services are not sold separately, there are three pricing strategies, as follows: Adjusted market assessment approach â€" The entity will evaluate the market in which it sells goods or services and estimate the price a customer in that market would be willing to pay for those goods or services. Residual approach â€" The entity will estimate the standalone selling price by reference to the total transaction price less the sum of the observable standalone selling prices of other goods or services promised in the contract. However, an entity may only use a residual approach to estimate the standalone selling price of a good or service only if one of the following criteria is met ASC , paragraph The entity sells the same good or service to different customers at or near the same time for a broad range of amounts that is, the selling price is highly variable because a representative standalone selling price is not discernible from past transactions or other observable evidence. The entity has not yet established a price for that good or service, and the good or service has not previously been sold on a standalone basis that is, the selling price is uncertain. An entity may also combine these approaches if the goods or services promised have high variability or uncertainty in their pricing. Discounts, rebates, and other price concessions included in a contract also need to be included in the allocation of the purchase price. For example, when a customer earns a free night hotel stay with every 10 nights, the hotel would allocate the transaction price over the combined 11 nights. Allocating these items may be difficult when goods or sales a bundled together. Additionally, a discount or rebate may only apply to specified goods, which would further complicate the allocation process.

Chapter 9 : Identifying Performance Obligations - Revenue Recognition

A discharge of obligations means that parties to the contract are no longer liable for any terms of the agreement, and no further promises may be enforced. There are a number of ways in which this can occur, including agreement, performance and breach.