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The HKICPA's Standard Setting Department welcomes your comments and feedback on this paper, which should be sent to [commentletters@hkicpa.org.hk](mailto:commentletters@hkicpa.org.hk).

### **Recognition of IPO sponsor fee income under HKFRS 15 Revenue from Contracts with Customers**

#### **Background**

The core principle in HKFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. An entity recognises revenue in accordance with that core principle by applying the following five-step model:

Step 1: Identify the contract(s) with a customer – the requirements of HKFRS 15 apply to each contract that has been agreed with a customer and meets specified criteria.

Step 2: Identify the performance obligations in the contract – a contract includes promises to transfer goods or services to a customer. If those goods or services are distinct, the promises are performance obligations and are accounted for separately.

Step 3: Determine the transaction price – this is the amount of consideration in a contract to which an entity expects to be entitled in exchange for transferring promised goods or services to the customer.

Step 4: Allocate the transaction price to the performance obligations in the contract – an entity allocates the transaction price to each performance obligation on the basis of the relative standalone-selling price of each distinct good or service promised in the contract.

Step 5: Recognise revenue when (or as) an entity satisfies a performance obligation – an entity recognises revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to the customer (which is when the customer obtains control of that good or service).

This FAQ addresses recognition of IPO sponsor fee income under HKFRS 15 by a sponsor in Hong Kong. The background in this FAQ was provided by members of the Institute's Securities Regulatory Advisory Panel and represents a typical IPO sponsor arrangement. The FAQ highlights the major issues that are likely to be encountered in applying HKFRS 15's five step-model to the fact pattern in this FAQ, in particular issues relating to the identification of the performance obligation, determination of the transaction price, recognition of revenue over time versus at a point in time, and choosing an appropriate method of measuring progress if revenue is recognised over

time. It also provides references on the key considerations in addressing these issues. Other issues, considerations and analysis may be necessary for a different fact pattern.

The Stock Exchange of Hong Kong (the Exchange) requires a listing applicant to engage a sponsor for the listing of the applicant's shares on the Exchange. With reference to the Listing Rules paragraph 3A.11, in summary, the sponsor's role is to be closely involved in the preparation of the listing document, conduct reasonable due diligence, ensure specified preliminary application requirements in the Listing Rules are complied with, address matters raised by the Exchange in connection with the listing application, accompany the applicant to any meeting with the Exchange and attend other meetings requested by the Exchange and comply with the terms of the undertaking and statement of independence given to the Exchange by the sponsor.

The contract between the sponsor and the applicant usually describes multiple services to be carried out by the sponsor, including coordination with various professional parties, performance of due diligence of the listing applicant, review of the listing document, communication with the Exchange and other regulators, provision of compliance, restructuring and IPO pricing advisory, performance of post-listing services, etc. Some services may be included in the contract but may not be part of the role of a sponsor in accordance with the Listing Rules. Where this FAQ refers to 'sponsor' it refers only to the sponsor acting in its role required by the Listing Rules. Such sponsor services are usually highly interdependent and interrelated, and are provided with an overall objective of assisting the applicant in progressing towards a successful listing. This FAQ does not cover other services that are outside the role of the sponsor.

Typical payment terms in an IPO sponsor contract are as follows:

- the sponsor receives an initial deposit from the listing applicant upon signing the contract.
- the sponsor is entitled to further payments if and when stated milestones in the contract are reached, for example additional amounts may be payable to the sponsor upon the submission of the listing application to the Exchange, upon the hearing of the listing application and upon the listing of the applicant's shares on the Exchange.
- the payments for the deposit and at each respective milestone become unconditional upon the milestone being reached and are non-refundable.

Profit margins will vary depending on the contract/sponsor. However, in a typical arrangement, the majority of the sponsor's direct costs are usually incurred before submission of the listing application to the Exchange.

## Question 1

How many performance obligations are there in the sponsor contract? And what is (are) the performance obligation(s)?

### Answer

HKFRS 15.22 states:

At contract inception, an entity shall assess the goods or services promised in a contract with a customer and shall identify as a performance obligation each promise to transfer to the customer either:

- (a) a good or service (or a bundle of goods or services) that is distinct; or

- (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

**HKFRS 15.27 states:**

- A good or service that is promised to a customer 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 (ie the good or service is capable of being distinct); and
  - (b) the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract).

HKFRS 15.27(a) requires consideration of whether the listing applicant could 'benefit' from the services provided by a sponsor before the sponsor completes all of the specified services (for example before the listing of the shares on the Exchange or other outcome of the contract). Paragraph 3A.18 of the Listing Rules states "For the avoidance of doubt, a replacement sponsor shall not be regarded as having satisfied any of the obligations of a sponsor by virtue of work performed by a predecessor sponsor". It is unlikely that a listing applicant can obtain the 'benefit' from the sponsor services until the existing sponsor completes all its services up to listing (or another final outcome of the contract). This is because the applicant cannot benefit from partially completed services provided by the existing sponsor to date together with other resources readily available to it.

For example, if the applicant were to replace the existing sponsor, the replacement sponsor would need to substantially re-perform all of the work performed by the existing sponsor, such as reperform the due diligence of the applicant, the review of the listing document, the compliance checks, etc.

The services carried out by the sponsor in its role as sponsor are usually highly interdependent and interrelated and therefore, in accordance with HKFRS 15.29(c), these services also fail to satisfy the criterion in HKFRS 15.27(b) of being distinct from one another within the context of the contract. Therefore, the sponsor accounts for all of the sponsor services promised in the contract as a single performance obligation [HKFRS 15.30].

If a sponsorship arrangement between a sponsor and a listing applicant is structured as two or more contracts, this would not necessarily change the above conclusion as a sponsor would need to consider whether those contracts should be combined and accounted for as a single contract applying HKFRS 15.17.

**HKFRS 15.17 states:**

An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

- (a) the contracts are negotiated as a package with a single commercial objective;
- (b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or
- (c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation.

However, a sponsor should also assess whether any additional services offered to the listing applicant that go beyond the role of a sponsor are distinct and should be identified as a separate performance obligation. For example, a sponsor may also act as the underwriter of the listing applicant, bearing the risk of being unable to sell the

underlying listing applicant's shares and the cost of holding them. The underwriter's role is different from the role of a sponsor and the listing applicant can benefit from the underwriting services on their own, with a different entity providing sponsor services, which would satisfy HKFRS 15.27(a). Also, there is no change in the sponsor's obligations whether or not they also act as underwriter and therefore HKFRS 15.27(b) would also be satisfied because the promise to transfer the sponsor services is separately identifiable from the promise to transfer the underwriting services. Thus, the underwriting services would be identified as a distinct performance obligation, separate from the sponsor services. This FAQ does not further consider other services provided that go beyond the role of a sponsor.

## Question 2

What is the transaction price of the contract?

### Answer

#### HKFRS 15.47 states:

An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

#### HKFRS 15.51 states:

An amount of consideration can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

The amount of consideration might be variable even when the stated price in the contract is fixed because the entity may be entitled to part of the consideration only upon occurrence or non-occurrence of a future event, for example submission of the listing application, or the entity is willing to accept a lower amount of consideration than the stated price, for example if the listing application is unsuccessful. Often the amount of sponsor fee income ultimately received by the sponsor under the contract may be less than the total contractual amount if one or more of the milestones in the contract are not met.

#### HKFRS 15.50 states:

If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer.

#### HKFRS 15.56 states:

An entity shall include in the transaction price some or all of an amount of variable consideration estimated only to the extent that it is highly probable that a significant reversal in the amount of cumulated revenue recognised will not occur when uncertainty associated with the variable consideration is subsequently resolved.

#### HKFRS 15.57 states:

In assessing whether it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur once the uncertainty related to the variable consideration is subsequently resolved, an entity shall consider both the likelihood and the magnitude of the revenue reversal. Factors that could increase the likelihood or the magnitude of a revenue reversal include, but are not limited to, any of the following:

- (a) the amount of consideration is highly susceptible to factors outside the entity's influence. Those factors may include volatility in a market, the judgement or actions of third parties, weather conditions and a high risk of obsolescence of the promised good or service.
- (b) the uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- (c) the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value
- (d) the entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- (e) the contract has a large number and broad range of possible consideration amounts.

**HKFRS 15.59 states:**

At the end of each reporting period, an entity shall update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period...

The sponsor will need to assess the probability of meeting the different milestones in the contract and also the likelihood of granting a price concession when determining the transaction price, and reassess the amount of variable consideration estimated at the end of each reporting period.

In particular, HKFRS 15.56 will need to be considered in respect of the contingent milestone payments if the sponsor meets the criteria for the sponsor fee income to be recognised over time (see Question 3).

For example, given that the successful submission of the listing document is not within the control of the sponsor, it is unlikely that the milestone payment receivable on the submission of the listing document could be included in the transaction price recognised as revenue prior to the date of submission, as this variable amount of consideration would be constrained by HKFRS 15.56 unless at the reporting date it was highly probable that the listing document will be filed [HKFRS 15.57(a)] or the sponsor has an enforceable right to payment for its performance completed to date even if the submission is not successful (discussed further below).

Disclosures in respect of the judgement applied in determination of the transaction price are required in the financial statements (as highlighted in Question 6).

### **Question 3**

Should IPO sponsor fee income be recognised over time or at a point in time?

#### **Answer**

**HKFRS 15.31 states:**

An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

An entity satisfies a performance obligation when it transfers control of the promised good or service underlying that performance obligation to the customer. Consequently, assessing when control of a good or service is transferred is a critical step in applying HKFRS 15.

HKFRS 15.33 states that "control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset". It can be difficult to apply the concept of control to a promised service because in most service contracts the service asset is simultaneously created and consumed and so no asset is ever recognised by the customer. For this reason, specific criteria are given in HKFRS 15.35 to provide an objective basis for assessing when control transfers over time and thus the timing of when a performance obligation is satisfied.

**HKFRS 15.35 states:**

An entity transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognises revenue over time, if one of the following criteria is met:

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

Following the fact pattern provided, the sponsor arrangement does not meet criterion (a) because the listing applicant does not simultaneously receive and consume the benefits provided by the sponsor's performance during the IPO process. The listing applicant only receives the benefits when the sponsor completes all of its services before the listing of the shares on the Exchange or another outcome. Applying paragraph 3A.18 of the Listing Rules, the performance obligation does not meet the condition in HKFRS 15.B4 to be considered satisfied over time because a replacement sponsor would need to substantially re-perform all of the work performed by the existing sponsor (as explained under Question 1), including reperformance of the due diligence work and coordination with other professional parties. Even if some of the work done by other professional parties (such as lawyers and auditors) has been completed, this work is not part of the role of the sponsor. The sponsor will still need to coordinate with other professional parties and perform its own due diligence on the information provided by these parties.

The sponsor arrangement also does not meet criterion (b) because there is no asset controlled by the listing applicant during the period.

Accordingly, in determining whether a sponsor should recognise sponsor fee income at a point in time or over time, the focus should be on criterion (c). In particular, a sponsor has to consider:

- whether the sponsor has a right to payment for performance completed to date at all times throughout the duration of the contract [HKFRS 15.37]; and
- whether that right to payment is enforceable.

*Right to payment for performance completed to date*

**HKFRS 15.37 states:**

... at all times throughout the duration of the contract, the entity must be entitled to an amount that at least compensates the entity for performance completed to date if the contract is terminated by the customer or another party for reasons other than the entity's failure to perform as promised...

**HKFRS 15.B9 states:**

...An amount that would compensate an entity for performance completed to date would be an amount that approximates the selling price of the goods or services transferred to date (for example, recovery of the costs incurred by an entity in satisfying the performance obligation plus a reasonable profit margin) rather than compensation for only the entity's potential loss of profit if the contract were to be terminated. Compensation for a reasonable profit margin need not equal the

profit margin expected if the contract was fulfilled as promised, but an entity should be entitled to compensation for either of the following amounts:

- (a) a proportion of the expected profit margin in the contract that reasonably reflects the extent of the entity's performance under the contract before termination by the customer (or another party); or
- (b) a reasonable return on the entity's cost of capital for similar contracts (or the entity's typical operating margin for similar contracts) if the contract-specific margin is higher than the return the entity usually generates from similar contracts.

In practice, the upfront non-refundable payment plus the cumulative milestone payments may compensate the sponsor for performance completed to date at the date each of the milestones are met. However, a sponsor will need to assess whether it is entitled to an amount that at least compensates for its performance completed to date between milestones and at all times throughout the contract, not only at the date of the milestone.

HKFRS 15 is silent on whether compensation for a reasonable profit margin is based on a constant margin over the duration of the contract. A sponsor's view of what constitutes a reasonable margin on a contract might vary between milestones depending on the nature of work performed and associated risk. Furthermore, at times during the contract, the sponsor might consider that compensation for a reasonable margin is less than the profit margin expected if the contract was fulfilled as promised.

For example:

- the sponsor might determine that its risk exposure increases subsequent to the submission of the listing application document and thus a reasonable margin would be higher after submission compared to before submission. The additional payment received upon submission may be structured to compensate for the increase in risk for the sponsor caused by that event and thus increases the profit margin on the contract to date.
- even if the compensation is less than the profit margin on that particular contract, it might be higher than the profit margin on other contracts entered into by the sponsor that are similar but less profitable. The sponsor might determine that the profit margin on the less profitable contracts would constitute a reasonable margin for the contract being assessed.

A sponsor may consider the profit margin on similar contracts or other contracts, with appropriate adjustments, when assessing whether compensation for a reasonable profit margin is within a sensible range. Judgement will be required in assessing what constitutes a reasonable profit margin over the contract and appropriate evidence will be required to support the conclusions made [with specific consideration of HKFRS 15.B9(a) – (b)].

The table below outlines two illustrative milestone payment schedules in sponsor arrangements in Hong Kong, and provides an analysis of whether they might provide the sponsor with a right to payment for the performance completed to date at all times throughout the contract:

Milestone payment schedule	Analysis										
<u>Scenario 1</u> The total costs of the sponsor under the contract approximate one third of the total sponsor fee. Payment is as follows: <table border="1"> <thead> <tr> <th>Milestone</th><th>Payment (% of total consideration)</th></tr> </thead> <tbody> <tr> <td>Signing of contract</td><td>60%</td></tr> <tr> <td>Submission of listing application document</td><td>20%</td></tr> <tr> <td>Listing approval meeting</td><td>10%</td></tr> <tr> <td>Successful listing of shares</td><td>10%</td></tr> </tbody> </table> <p>The contract does not specify payment termination clauses which would require payment for work performed by the sponsor subsequent to the last milestone upon termination.</p>	Milestone	Payment (% of total consideration)	Signing of contract	60%	Submission of listing application document	20%	Listing approval meeting	10%	Successful listing of shares	10%	In this scenario, the 60% initial deposit received (which is non-refundable) is more than the costs expected to be incurred by the sponsor and therefore, depending on specific facts and circumstances, it is possible that this deposit provides a reasonable margin up to submission of the listing application document. The risk of the sponsor may be considered to increase once the listing application document is submitted and the subsequent milestone payments received by the sponsor may compensate for the increase in risk profile and sufficiently improve the profit margin of the contract to date. If this is the case, then the sponsor might effectively have a contractual right to payment for performance completed to date at all times during the contract provided that the initial deposit and the subsequent milestone payments are non-refundable. There are no explicit payment termination clauses to consider.
Milestone	Payment (% of total consideration)										
Signing of contract	60%										
Submission of listing application document	20%										
Listing approval meeting	10%										
Successful listing of shares	10%										
<u>Scenario 2</u> The total costs of the sponsor under the contract approximate one third of the total sponsor fee. Payment is as follows: <table border="1"> <thead> <tr> <th>Milestone</th><th>Payment (% of total consideration)</th></tr> </thead> <tbody> <tr> <td>Signing of contract</td><td>20%</td></tr> <tr> <td>Submission of listing application document</td><td>50%</td></tr> <tr> <td>Listing approval meeting</td><td>20%</td></tr> <tr> <td>Successful listing of shares</td><td>10%</td></tr> </tbody> </table> <p>There is a specific termination clause in the contract which entitles the sponsor to receive a payment pro-rata to its performance completed to date if the contract is terminated by the applicant or another party.</p>	Milestone	Payment (% of total consideration)	Signing of contract	20%	Submission of listing application document	50%	Listing approval meeting	20%	Successful listing of shares	10%	In this scenario 2, the initial deposit is only 20% of the total contract payments and therefore may not be sufficient to cover the costs plus a reasonable margin during the period before the submission of the listing application document. If so, the sponsor is unlikely to have a contractual right to payment for the performance completed to date if the assessment is solely based on the milestone payment schedule. However, in this scenario there are explicit terms in the contract which specify that the sponsor is entitled to payment for performance completed to date upon termination of the contract. Therefore, the sponsor is likely to have a contractual right to payment for performance completed to date because of the explicit termination clause.
Milestone	Payment (% of total consideration)										
Signing of contract	20%										
Submission of listing application document	50%										
Listing approval meeting	20%										
Successful listing of shares	10%										

A sponsor would consider all of the payment and termination terms in the contract when determining whether it has a contractual right to payment for performance completed to date. The numbers used in the above scenarios are for illustration purpose only and should not be treated as bright lines leading to the corresponding outcome. A sponsor should perform the analysis considering all relevant fact and circumstances.

### *Enforceability of the right to payment*

HKFRS 15.B12 states:

In assessing the existence and enforceability of a right to payment for performance completed to date, an entity shall consider the contractual terms as well as any legislation or legal precedent that could supplement or override those contractual terms. This would include the assessment of whether:

- (a) legislation, administrative practice or legal precedent confers upon the entity a right to payment for performance to date even though that right is not specified in the contract with the customer;
- (b) relevant legal precedent indicates that similar rights to payment for performance completed to date in similar contracts have no binding legal effect; or
- (c) an entity's customary business practices of choosing not to enforce a right to payment has resulted in the right being rendered as unenforceable in that legal environment. However, notwithstanding that an entity may choose to waive its right to payment in similar contracts, an entity would continue to have a right to payment to date if, in the contract with the customer, its right to payment for performance to date remains enforceable.

A sponsor has to ensure that the payment and termination terms in the contract are legally enforceable when assessing whether it has an enforceable right to payment for performance completed to date, especially if relying on termination clauses rather than on non-refundable amounts received to satisfy HKFRS 15.35(c). A sponsor is recommended to seek legal advice on the enforceability of any contractual payment and termination terms.

If the contract does not explicitly state that the sponsor has a right to payment for performance upon termination, the sponsor should not assume it has such right based on customary business practices without legal interpretation.

### *Summary*

Ultimately the assessment of whether a sponsor meets criterion (c) in HKFRS 15.35 and recognises sponsor fee income over time will depend on the specific terms in the contract and whether those terms are enforceable considering the relevant laws and regulations in Hong Kong. Subtle differences in contractual terms could result in different assessment outcomes.

### **Question 4**

If IPO sponsor fee income meets the criteria in HKFRS 15.35 to be recognised over time, what is an appropriate method for measurement of progress?

### Answer

HKFRS 15.39 states:

...The objective when measuring progress is to depict an entity's performance in transferring control of goods or services promised to a customer (ie satisfaction of an entity's performance obligation).

A sponsor is required to select an appropriate method to measure the progress towards complete satisfaction of the performance obligation in the contract.

HKFRS 15.40 states:

An entity shall apply a single method of measuring progress for each performance obligation satisfied over time and the entity shall apply that method consistently to similar performance obligations and in similar circumstances.

**HKFRS 15.41 states:**

Appropriate methods for measuring progress include output methods and input methods...

...In determining the appropriate method for measuring progress, an entity shall consider the nature of the good or service that the entity promised to transfer to the customer.

HKFRS 15 does not provide a free choice of method for measuring progress, nor does it prescribe when an entity should use a particular method. When selecting an appropriate method, judgement is required. A sponsor should consider whether the related information that would be required to apply its chosen method is reliable and supportable, and whether the method would appropriately reflect the performance of the sponsor to date. A sponsor should also apply the selected method for measuring the progress consistently for similar performance obligations.

**HKFRS 15.B15 states:**

Output methods recognise revenue on the basis of direct measurements of the value to the customer of the goods or services transferred to date relative to the remaining goods or services promised under the contract. Output methods include methods such as surveys of performance completed to date, appraisals of results achieved, milestones achieved, time lapsed and units produced or unit delivered)...

**HKFRS 15.B18 states:**

Input methods recognise revenue on the basis of the entity's efforts or inputs to the satisfaction of a performance obligation (for example, resources consumed, labour hours expended, cost incurred, time elapsed or machine hours used) relative to the total expected inputs to the satisfaction of that performance obligation...

HKFRS 15 contains application guidance for evaluating and applying input and output methods and also considers when it would be appropriate for an entity to recognise revenue in the amount it has the right to invoice (as a practical expedient) [HKFRS 15.B15 - B19]. HKFRS 15 does not specify that only input or output methods can be used — other methods might be appropriate provided the selected method meets the requirements described above.

**HKFRS 15.B17 states:**

The disadvantages of output methods are that the outputs used to measure progress may not be directly observable and the information required to apply them may not be available to an entity without undue cost. Therefore, an input method may be necessary.

**HKFRS 15.BC164 of the Basis for Conclusions accompanying HKFRS 15 states:**

The boards decided that, conceptually, an output measure is the most faithful depiction of an entity's performance because it directly measures the value of the goods or services transferred to the customer.

However, the boards observed that it would be appropriate for an entity to use an input method if that method would be less costly and would provide a reasonable proxy for measuring progress.

**Question 5**

Why is recognising the initial deposit and/or milestone payments in full upon receipt of cash usually not appropriate under HKFRS 15?

**Answer**

Before adoption of HKFRS 15, a practice had developed where many sponsors recognised revenue based on milestones achieved (ie revenue was recognised in lump sum amounts when milestone payments were received). Some may also have recognised the initial deposit in full upon receipt.

Payment schedules are usually determined by commercial factors, including the bargaining/negotiation power between the sponsor and the listing applicant, the costs incurred by the sponsor at a milestone date or the corresponding value of the sponsor's output at a milestone date from the applicant's point of view. Consequently, cash received may not necessarily reflect the services performed and revenue earned by the entity.

In particular, the initial non-refundable deposit is often received before the sponsor commences providing services to the applicant and so is highly unlikely to be representative of the value of the sponsor's services received from the listing applicant's point of view at this date. Consequently, the deposit would not be recognised as revenue upon cash receipt. Instead the deposit would be recognised as revenue according to the pattern which represents the value of services transferred to the applicant.

If the criteria in HKFRS 15.35 are met for overtime revenue recognition, HKFRS 15.B15 lists 'milestones reached' as a type of output method that might be considered if it faithfully depicts an entity's performance to date. In determining whether it is appropriate to apply an output method based on milestone payments under HKFRS 15 (including whether the sponsor can apply the practical expedient under HKFRS 15.B16 that results in a similar revenue recognition outcome), judgement will be required to evaluate whether the milestone payments correspond directly with the value of services transferred to the listing applicant, and hence the sponsor's progress towards complete satisfaction of the performance obligation. A sponsor should not presume the negotiated milestones payment schedule automatically reflects the value of services transferred to the listing applicant at each milestone.

In addition, when a milestone event is reached the sponsor may need to reassess the transaction price (see Question 2).

## Question 6

What are some other key considerations for a sponsor?

Answer

In addition to the issues described above, a sponsor will need to consider other aspects of HKFRS 15 relevant to their activities. The following are examples of key areas for consideration:

- Some contracts might not be completed as planned. Unanticipated problems can and often do arise, including delays in the listing timetable. Therefore an entity may need to consider whether there is a modification to the scope and/or the price of the contract that should be accounted for as a contract modification [HKFRS 15.18]. A contract modification is a change in the scope or price (or both) of a contract that is approved by the parties to the contract, for example an approved extension of the track record period to incorporate the stub period in the listing application document. HKFRS 15.20 – 15.21 provide requirements on how to account for contract modifications. A sponsor has to assess whether the additional promised services are distinct and the increase in price reflects the standalone selling price of the additional promised services, in order to determine whether the modification should be accounted for as a separate contract or modification of the original contract. If the additional services are services relating to a continuing role as sponsor, then it is unlikely that the additional services are distinct for the reasons explained in Question 1 and therefore HKFRS 15.21(b) will apply.

- A discretionary bonus might be paid to employees in addition to their basic salary.
  - If the bonus is for obtaining a specific sponsor contract, it is a contract acquisition cost. Such incremental costs are recognised as an asset if the entity expects to recover the costs [HKFRS 15.91]. As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less [HKFRS 15.94].
  - If the bonus is in relation to an individual's performance on a particular contract, it should be considered together with other costs of fulfilling the contract in assessing the reasonableness of the profit margin when determining whether the sponsor is entitled to compensation for performance completed to date under HKFRS 15.37 and B9 above [HKFRS 15.95].
- Other costs may be incurred during the bidding process, for example entertainment costs and due diligence costs. A sponsor has to assess whether the costs incurred are incremental costs that are directly related to the acquisition of a contract and recognised as an asset applying HKFRS 15.91 or costs to fulfil an anticipated contract that might be recognised as an asset applying HKFRS 15.95. If these other costs do not fall into either of these categories then they are recognised as an expense when incurred unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained [HKFRS 15.93].
- A sponsor is required to disclose the judgements made in applying HKFRS 15 that significantly affect the determination of the amount and timing of revenue. In particular, a sponsor will need to explain the judgements used in determining the timing of satisfaction of the performance obligation (ie. whether, and why, the sponsor fee income is recognised over time or at a point in time) and determining the transaction price (for example in estimating variable consideration). HKFRS 15.123 -15.126 describe the detailed disclosures required about such judgements. A sponsor is also required to disclose the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied/partially unsatisfied as of the end of the reporting period together with an explanation of when the entity expects to recognise this amount as revenue [HKFRS 15.120].