

# Revenue, Section 3400 — Background Information and Basis for Conclusions

## Foreword

In November 2022, the Accounting Standards Board (AcSB) amended REVENUE, Section 3400 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for these amendments.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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## Introduction

- 1 This document summarizes considerations that were deemed significant by members of the AcSB in reaching their conclusions to amend REVENUE, Section 3400. This document sets out the reasons the AcSB undertook to develop the amendment, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others.

## Background

- 2 In May 2019, the AcSB issued its Exposure Draft to address stakeholders' concerns with Section 3400. Stakeholders noted a lack of application guidance and illustrative examples in the standard pertaining to certain complex revenue topics, including upfront non-refundable fees or payments.
- 3 The main proposal in the Exposure Draft was to add an appendix to Section 3400 containing additional guidance on the complex revenue topics for which many stakeholders expressed concerns. This guidance was derived from superseded guidance in Part V of the Handbook (primarily from the Emerging Issues Committee Abstracts (EICs)).
- 4 The application guidance and illustrative examples pertaining to upfront non-refundable fees or payments were derived from EIC-141, *Revenue Recognition*. With the lack of guidance in Section 3400, many stakeholders referred to EICs and other superseded guidance in the pre-changeover standards. By adding the application guidance to the Handbook, it was formalized as authoritative.
- 5 Stakeholders did not express concerns with the proposed amendments pertaining to upfront non-refundable fees or payments during the Exposure Draft comment period. Therefore, the AcSB finalized these amendments as exposed.
- 6 The AcSB approved amendments to Section 3400 in October 2019 and issued them in the Handbook in December 2019. The effective date for the amendments was initially set for periods beginning on or after January 1, 2021, but was subsequently deferred to January 1, 2022, in response to the COVID-19 pandemic. The amendments are applicable retroactively.
- 7 As entities started to apply these amendments, the AcSB heard of application challenges from stakeholders, particularly related to non-refundable initiation and life membership fees. These stakeholders were concerned about the decision-usefulness of deferring upfront non-refundable fees over long membership durations and the associated cost of applying the amendments.
- 8 The AcSB heard that many entities collecting non-refundable initiation and life membership fees (e.g., golf clubs) are currently recognizing revenue upfront. Some of these organizations applied the guidance in EIC-105, *Revenue Recognition of Non-refundable Initiation fees in Not-for-Profit Organizations*, prior to the introduction of Part III of the

Handbook. After adopting Part III, these entities continued with their existing revenue recognition policy in the absence of application guidance for upfront non-refundable fees or payments.

- 9 EIC-105 stated that revenue from non-refundable initiation or life membership fees should be recognized when all material conditions relating to the initiation fees have been substantially performed. Substantial performance is considered to have occurred when:
    - (a) the not-for-profit organization grants the use of its facilities and services to the new members;
    - (b) the not-for-profit organization has no remaining obligation or intent — by agreement, practice or legislation — to refund amounts received or forgive unpaid amounts owing; and
    - (c) there are no other material unfulfilled conditions affecting completion of the transaction.
  - 10 When the application guidance was added to Section 3400, the AcSB did not incorporate similar guidance to that contained in EIC-105.
  - 11 The application guidance added to Section 3400 included the following guidance related to upfront non-refundable fees or payments:
    - A45. ...In some circumstances, the right, product or service provided in conjunction with the non-refundable fee has no utility to the buyer separate and independent of the seller's performance of the other elements of the arrangement. In the absence of the seller's continuing involvement under the arrangement, the buyer would not have paid the fee.
    - A46. Revenue is deferred when the upfront fee is in exchange for products delivered or services performed that have no utility to the buyer separate and independent of the enterprise's performance of the other elements of the arrangement.
  - 12 Given this guidance, most organizations with non-refundable initiation and life membership fees concluded that such fees do not have stand-alone "utility to the buyer" and, therefore, should be deferred and amortized into revenue. Some stakeholders also noted that it is challenging for entities to demonstrate they are providing a service that has stand-alone utility to the buyer in exchange for the initiation fee.
  - 13 Some stakeholders also highlighted that the concept of "utility to the buyer" is not defined in the application guidance, nor is it used anywhere else in Section 3400.
  - 14 The AcSB also heard that all the illustrative examples related to upfront fees concluded that the fees should be deferred and none of the examples provided scenarios where upfront fees could be recognized at inception.
  - 15 Some stakeholders noted that in some circumstances recognizing non-refundable initiation and life membership fees upfront into revenue represented decision-useful information to users of the financial statements. These stakeholders thought that if the entity has no remaining performance obligation in exchange for the fee, upfront revenue recognition should be permitted.
  - 16 Other stakeholders said that non-refundable initiation and life membership fees should be deferred. They thought that deferring the recognition of revenue results in a more faithful representation of revenue as the entity provides services with utility to the buyer over the life of the membership.
  - 17 Most stakeholders have acknowledged that individual contracts have many nuances that would need to be considered before concluding on the most appropriate accounting treatment.
- Deferring the effective date**
- 18 The AcSB considered either delaying the effective date of the amendments or withdrawing the guidance completely. Both options would allow the Board to analyze the amendments further, seek additional feedback and determine an appropriate course of action to address stakeholders' concerns.
  - 19 In determining whether to delay the effective date or withdraw the guidance, the AcSB considered why the amendments were issued in the first place. Before the Board issued the amendments in December 2019, many entities were asking for more guidance on how to account for upfront non-refundable fees or payments. This fee structure is typical for entities issuing software-licensing agreements. With the lack of guidance in Section 3400, entities referred to the superseded guidance in EIC-141 on how to account for these types of arrangements. By adding this guidance from EIC-141 to the Handbook, it was formalized as authoritative. For these types of entities, the amendments were beneficial and supported their accounting policy for upfront non-refundable fees or payments. By keeping the guidance in the standard, it will continue to support the accounting policies of entities who initially asked for it.
  - 20 The AcSB also considered whether to allow for early adoption of the amendments while it deliberates stakeholders' feedback. The Board heard from its Advisory Committees that many entities are far along in implementing the amendments and find them helpful for their financial reporting. These include entities collecting upfront non-refundable fees as part of software-licensing arrangements. The Board decided that early adoption should continue to be permitted because it results in more decision-useful information for the entities' financial statement users. The Board also encourages these entities to early adopt the amendments.
  - 21 The AcSB also considered whether a specific, new effective date should be set for the amendments to upfront non-refundable fees or payments or whether the deferral should be indefinite. The Board decided to specify a new effective

date since this provides clarity to stakeholders on when the Board anticipates completing a standard-setting project if one is deemed necessary.

- 22 In setting a new effective date, the AcSB considered the types of entities that will be scoped into its research and any potential standard-setting project. Entities that charge non-refundable initiation or life membership fees specifically have expressed concern with the amendments. They include for-profit entities applying Part II of the Handbook and not-for-profit entities applying Part III. The Board will focus its research on these types of entities. The Board noted that entities collecting certain types of upfront non-refundable fees, including fees related to the issuance of software licenses, have benefited from the added application guidance. The Board will exclude these types of arrangements from its research, and any amendments to the standard or guidance will not impact these entities. Due to the limited scope of this research, the Board thinks that it can complete any potential standard-setting project before January 1, 2025.
- 23 Exposure Draft respondents unanimously agreed with the Board's proposal to defer the effective date of amendments related to upfront non-refundable fees or payments to financial statements with fiscal years beginning on or after January 1, 2025, while continuing to allow early adoption. Respondents also generally agreed with the planned scope of the Board's research for a potential future project.

**Effective date**

- 24 The AcSB issued the amendments into Part II of the Handbook on November 15, 2022. The Board chose this date because the existing effective date for the application guidance on accounting for upfront non-refundable fees and payments was for fiscal years beginning on or after January 1, 2022. As such, the amendments were already effective when the revised effective date was being implemented. However, most private enterprises and NFPOs only issue year-end financial statements. Therefore, issuing the amendments before December 31, 2022, allows entities that had not early adopted the amendments to benefit from the deferred effective date.
  - 25 The AcSB also decided to continue to permit early application, which includes financial statements not yet authorized for issue. This allows entities to apply the amendments to their December 31, 2022, financial statements.
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