IFRS 15
Revenue from contracts with customers

Overview

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(4) Allocate the transaction price (Step 4)

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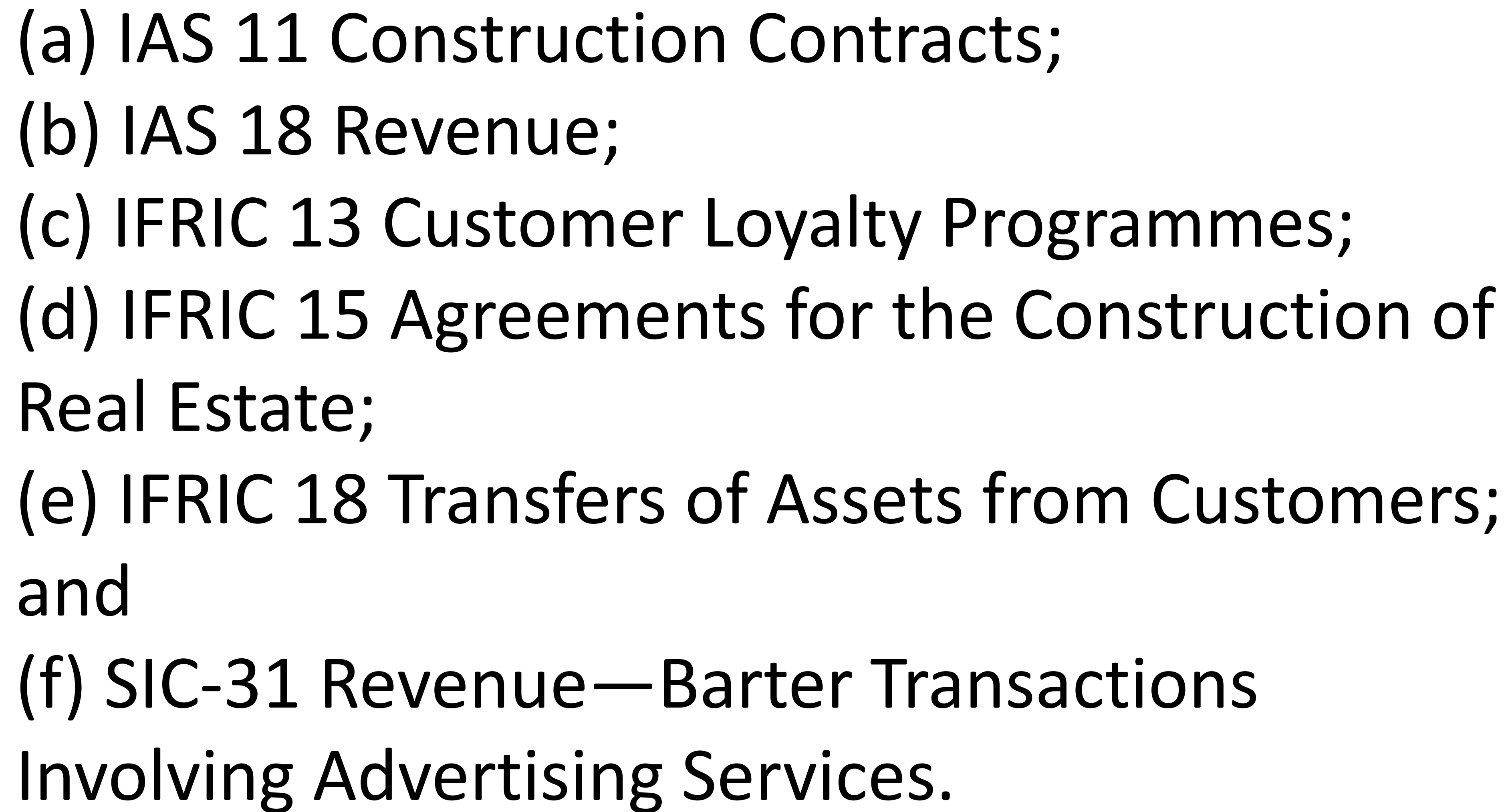
Introduction

IFRS 15 Revenue from Contracts with Customers was published by the International Accounting Standards Board (IASB) in May 2014. IFRS 15 sets out the requirements for **recognising revenue** that applies to all contracts with customers (except for contracts that are within the scope of the Standards on **Leases,** Insurance **contracts** and **Financial instruments).**

IFRS 15: revenue from contracts with customers

apply to all contracts with customers except:

1. **Leases** within the scope of IAS 17
2. **Insurance contracts** within the scope of IAS 4
3. **Financial instruments** IFRS 9, 10, 11 and IAS 27 and IAS 28
4. **Non- monetary exchanges** between entities in the same line of business



IFRS 15 supersedes:

(a) IAS 11 Construction Contracts;

(b) IAS 18 Revenue;

(c) IFRIC 13 Customer Loyalty Programmes;

(d) IFRIC 15 Agreements for the Construction of Real Estate;

(e) IFRIC 18 Transfers of Assets from Customers; and

(f) SIC-31 Revenue—Barter Transactions Involving Advertising Services.

Definitions – basic concepts

1. Income: Income is increases in **economic benefits** during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. (Revenue & gain)

2. Revenue: Income arising in the course of an entity's **ordinary activities**

Definitions – basic concepts

3. Contract: an agreement between two or more parties that creates **enforceable rights and obligations**

4. Contract asset: an entity's right to consideration in **exchange** for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (future performance)

Definitions – basic concepts

5. Receivable: An entity's right to consideration that is unconditional – i.e. only the **passage of time** is required before payment is due

6. Contract liability: An entity's **obligation to transfer** goods or services to a customer for which the entity has received consideration (or the amount is due) from the customer.

Definitions – basic concepts

7. Customer: A party that has contracted with an entity to obtain goods or services that are an output of the entity's **ordinary activities** in exchange for consideration.

8. Performance obligation. A promise in a contract with a customer 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 ad that have the same pattern of transfer to the customer.

Definitions – basic concepts

9. Stand-alone selling price: The price at which an entity would sell a promised good or service separately to a customer.

10. Transaction price: 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.

Revenue recognition: a five step process

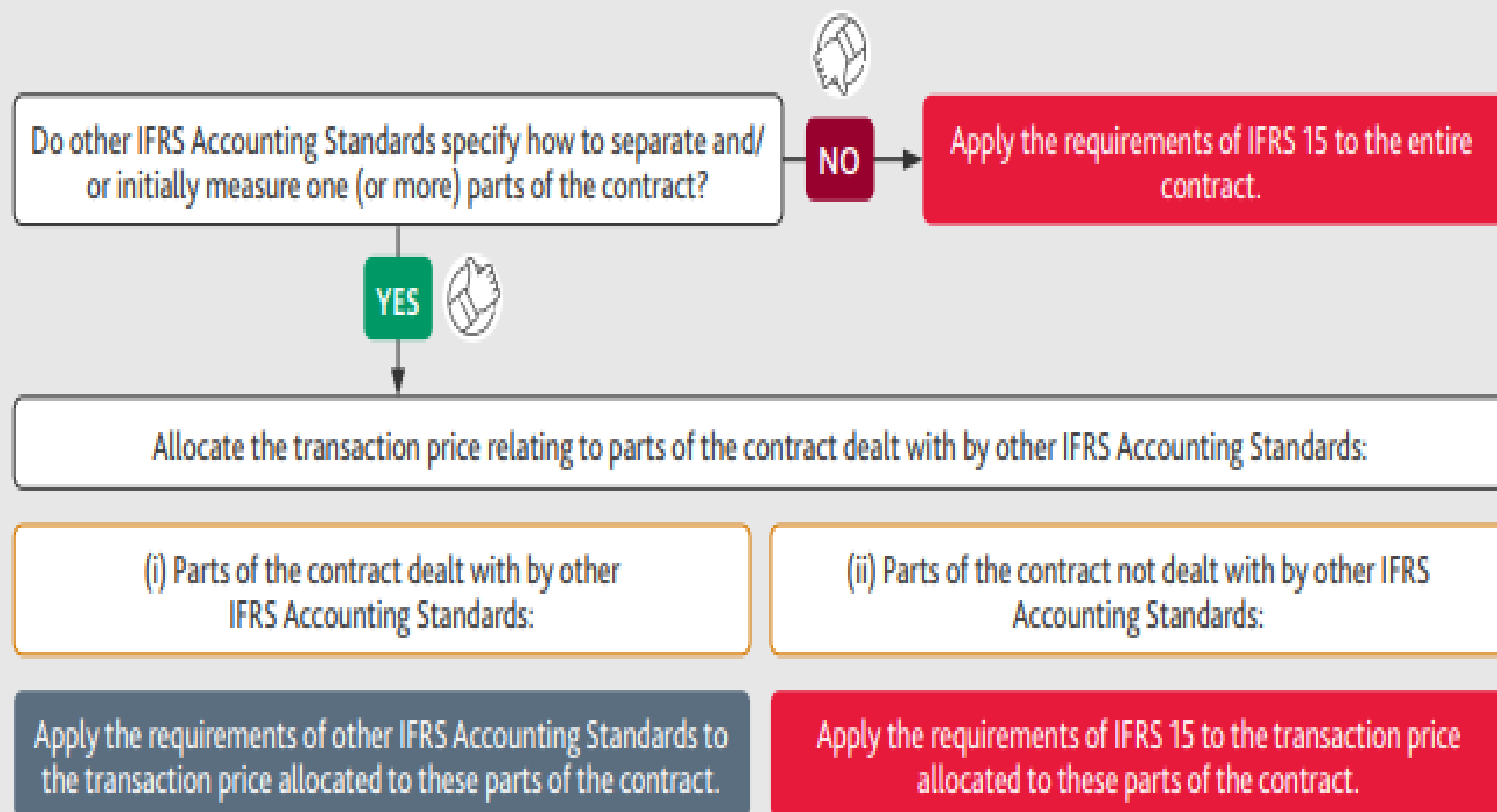
An entity recognizes revenue by applying the following five steps:

1) Identify the **contract.**
2) Identify the separate **performance obligations** within a contract
3) Determine the **transaction price.**
4) **Allocate** the transaction price to the performance obligations in the contract.
5) **Recognize** revenue when (or as) a performance obligation is satisfied.

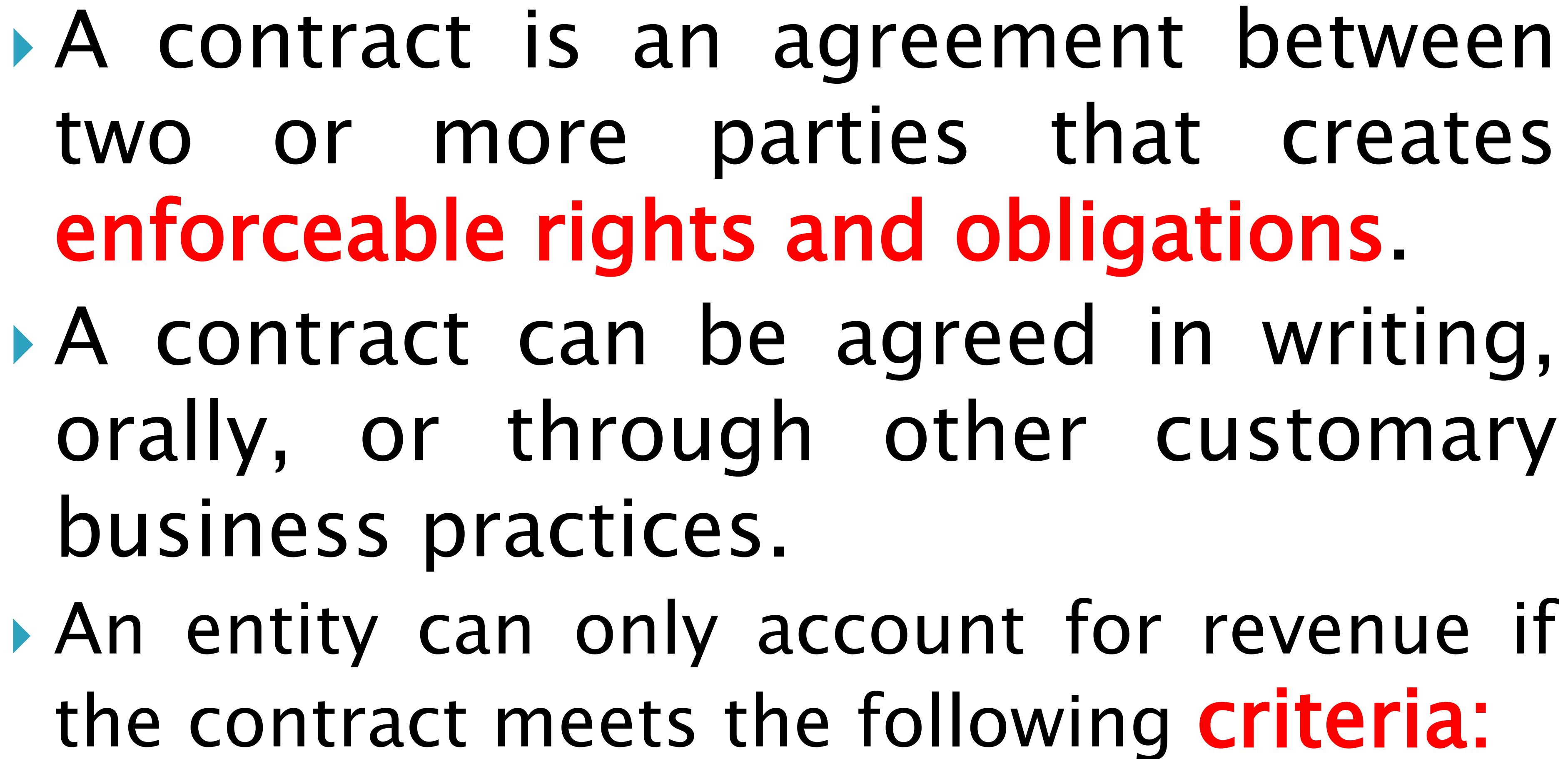
Revenue recognition: a five step process

The application of the core principle in IFRS 15 is carried out in five steps:

A contract may be partially within the scope of IFRS 15 and partially within the scope of other IFRS Accounting Standards . In this situation a vendor takes the approach summarised in the following diagram:



Step 1: Identify the contract



- A contract is an agreement between two or more parties that creates **enforceable rights and obligations**.
- A contract can be agreed in writing, orally, or through other customary business practices.
- An entity can only account for revenue if the contract meets the following **criteria:**

Step 1: Identify the contract

- the parties to the contract have **approved** the contract and are committed to perform their respective obligations
- the entity can identify **each party's rights** regarding the goods or services to be transferred
- the entity can identify **the payment terms** for the goods or services to be transferred
- the contract has **commercial substance**, and
- it is probable that the entity **will collect the consideration** to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

Step 2: Identifying the separate performance obligations within a contract

- Performance obligations are promises to transfer **distinct goods or services** to a customer. Some contracts contain more than one performance obligation.
- To be distinct if both of the following **criteria are met:**

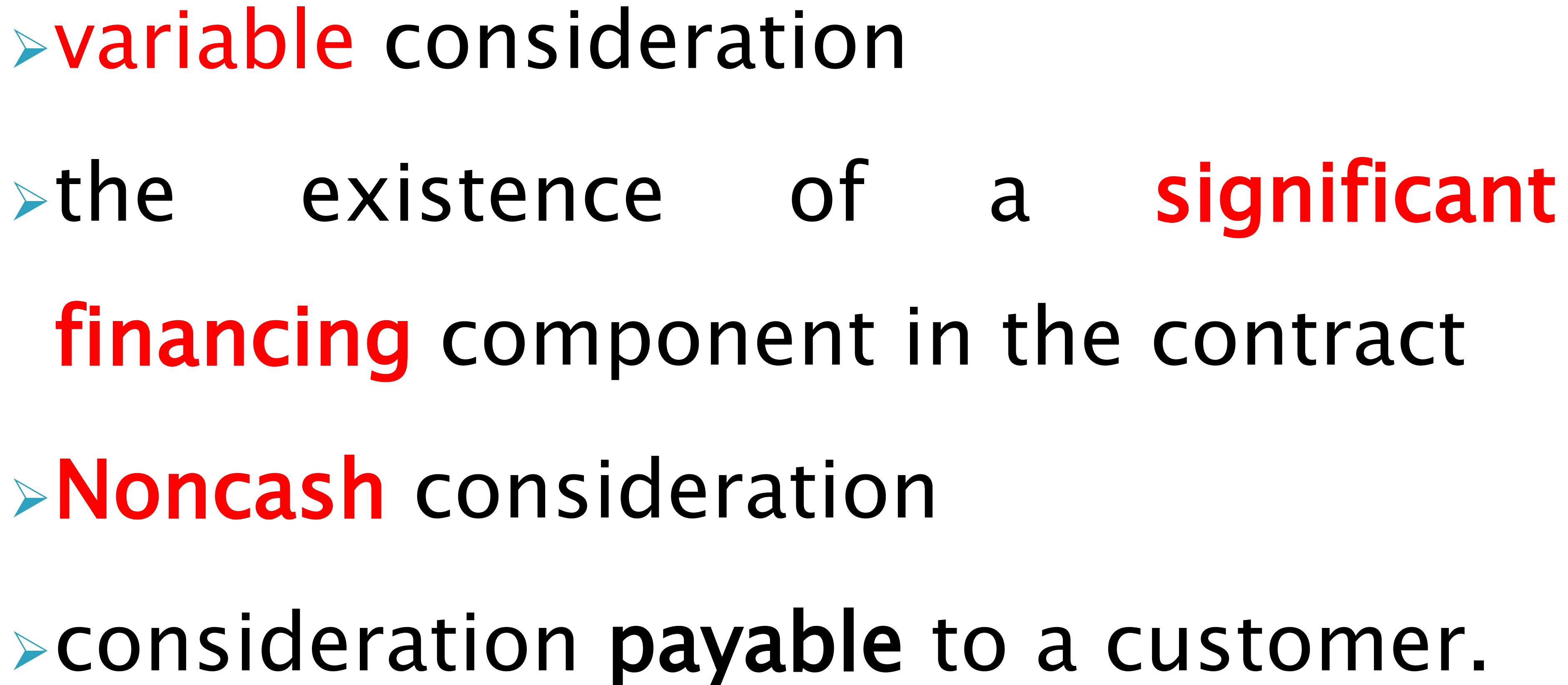
Step 2: Identifying the separate performance obligations within a contract

- Customer can **benefit** from goods or services on its own or wither other
- Goods or service is separately identifiable
- If an entity is an agent, then revenue is recognized based on the **fee or commission** to which it is entitled.

Step 3: Determining 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.
- Amounts collected on behalf of third parties (such as sales tax) are excluded.
- The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.
- When determining the transaction price, an entity shall consider the effects of **all of the following**:

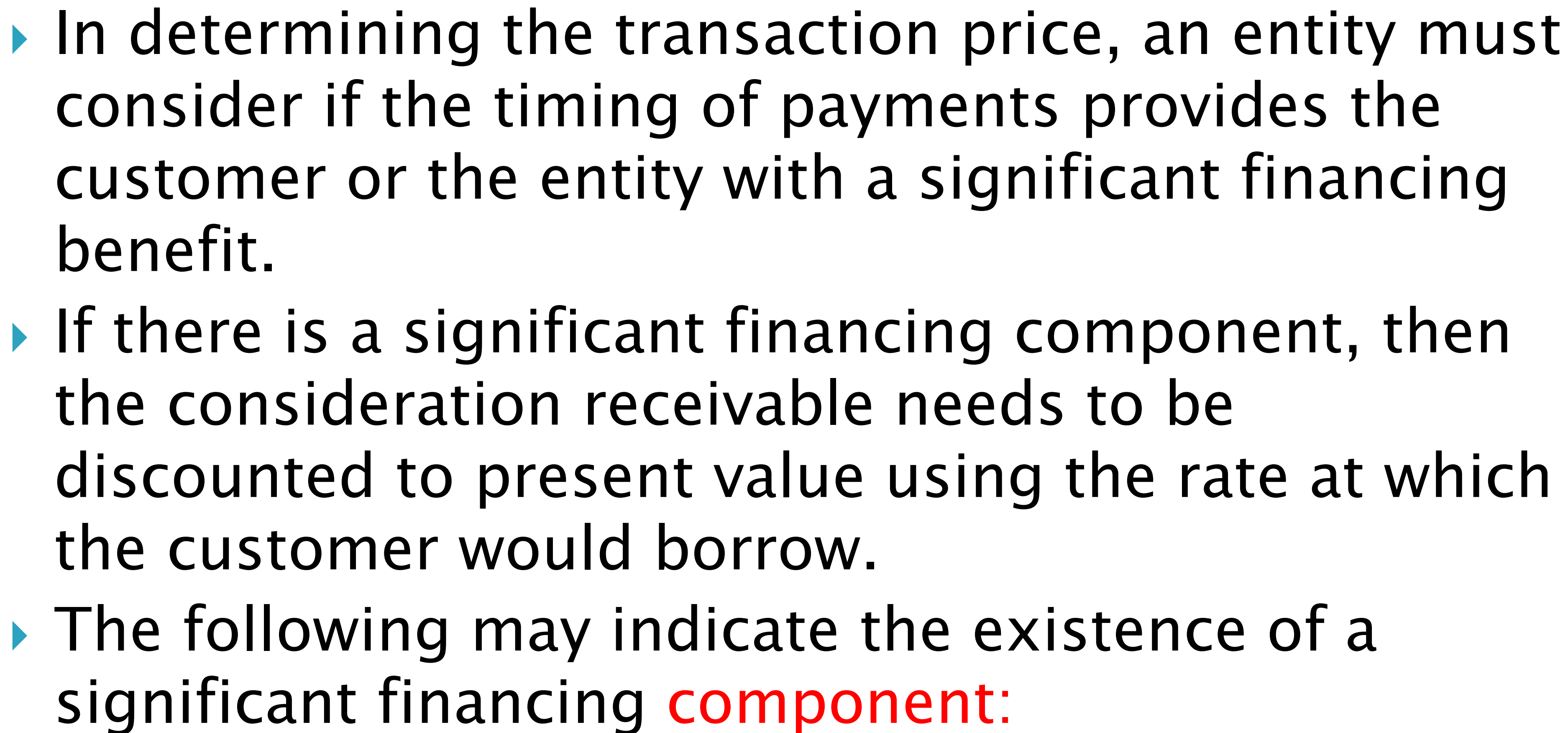
Step 3: Determining the transaction price



- variable consideration
- the existence of a **significant financing** component in the contract
- **Noncash** consideration
- consideration **payable** to a customer.

Step 3: Determining the transaction price

Financing



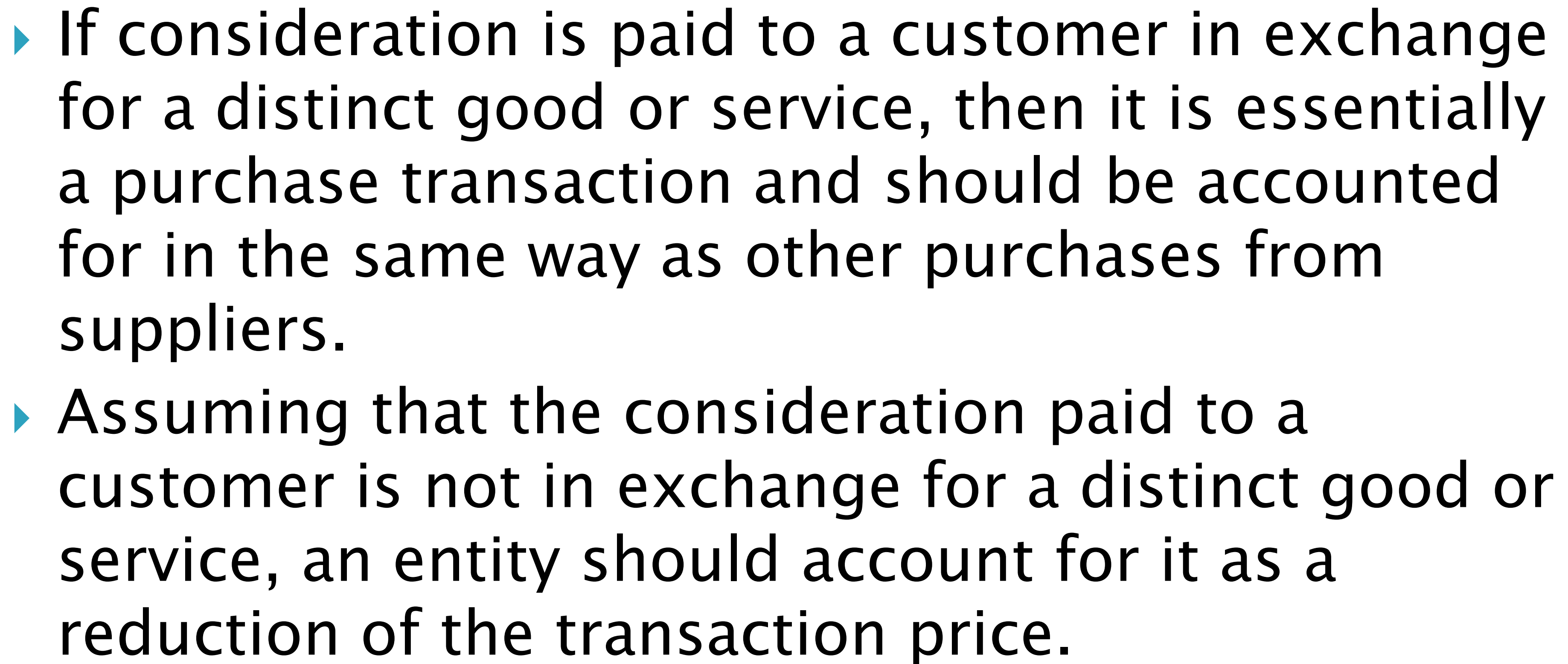
- In determining the transaction price, an entity must consider if the timing of payments provides the customer or the entity with a significant financing benefit.
- If there is a significant financing component, then the consideration receivable needs to be discounted to present value using the rate at which the customer would borrow.
- The following may indicate the existence of a significant financing component:

Step 3: Determining the transaction price

Financing

- the difference between the amount of promised consideration and the cash selling price of the promised goods or services
- the length of time between the transfer of the promised goods or services to the customer and the payment date.

Step 3: Determining the transaction price



Consideration payable to a customer

- If consideration is paid to a customer in exchange for a distinct good or service, then it is essentially a purchase transaction and should be accounted for in the same way as other purchases from suppliers.
- Assuming that the consideration paid to a customer is not in exchange for a distinct good or service, an entity should account for it as a reduction of the transaction price.

Step 4: Allocate the transaction price

- The total transaction price should be allocated to each performance obligation in proportion to standalone selling prices.
- The best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.
- If a standalone selling price is not directly observable, then the entity estimates the standalone selling price.

Step 4: Allocate the transaction price

Discounts

- In relation to a bundled sale, any discount should generally be allocated **across each component** in the transaction. A discount should only be allocated to a specific component of the transaction if that component is regularly sold separately at a discount.

Step 5: Recognize revenue

- Revenue is recognized when **(or as)** the entity satisfies a performance obligation by transferring a promised good or service to a customer.
- For each performance obligation identified, an entity must determine at contract inception whether it satisfies the performance obligation over time, or satisfies the performance obligation **at a point in time.**

Step 5: Recognize revenue

Satisfying a performance obligation at a point in time

- If a performance obligation is satisfied at a point in time then the entity must determine the point in time at which a customer **obtains control** of a promised asset.
- Control of an asset refers to the **ability to direct the use of**, and obtain substantially all of the remaining benefits (inflows or savings in outflows) from, the asset. Control includes the **ability to prevent other entities from obtaining benefits from an asset**.

The following are indicators of the transfer of control:

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

Transition at a glance

IFRS 15 is effective for reporting periods beginning on or after 1 January 2018 with early adoption permitted. It applies to new contracts created on or after the effective date and to existing contracts that are not yet complete as of the effective date. Therefore, the current year figures reported in the first year of adoption will be prepared as if the Standard's requirements had always been applied.

An entity can apply the revenue standard using two methods as follows:

Full retrospective method

- Under this method, an entity applies IFRS 15 retrospectively to each prior reporting period presented.

- With an effective date of 1 January 2018, an entity will apply the new standard to its historical transaction – and retrospectively adjust each comparative period presented in its 2017 financial statements.

Simplified transition method

An entity recognises the cumulative effect of initially applying IFRS 15 as an adjustment against retained earnings at the date of initial application (i.e. 1 January 2018) – and makes no adjustments to its comparative information (i.e. figures for the year ending 31 December 2017 will not be restated).

If an entity uses this transition method, it must disclose the impact of the change on the financial statement line items and include a description of the significant changes.

Other application issues

- 10.1 Sale with a right of return
- 10.2 Warranties
- 10.3 Principal vs agent considerations
- 10.4 Customer options for additional goods or services
- 10.5 Customers' unexercised rights (breakage)
- 10.6 Non-refundable up-front fees
- 10.7 Sales outside ordinary activities
- 10.8 Onerous contracts
- 10.9 Tooling

1. Consignment inventory

- This can raise the issue of **consignment inventory**, where one party legally owns the inventory but another party keeps the inventory on its premises. The key issue relates to which party has the majority of indicators of control.

2. Repurchase agreements

- A repurchase agreement is where an entity sells an asset but retains a right to repurchase the asset. This is often **not recognized as a sale,** but as a secured loan against the asset. Indications that this should not be recognized as a sale may include:
- Sale is below **fair value**.
- Option to repurchase is below the expected fair value.
- Entity continues to use the asset.
- Entity continues to hold the majority of risks and rewards associated with ownership of the asset.
- Sale is to a bank or financing company.

3. Bill and hold old arrangements

- A bill and hold arrangement is a contract under which an entity bills a customer for a product but the entity **retains** physical possession of the product until it is transferred to the customer at a point of time in the future.
- For this to be **recognized within revenue**, the customer must have obtained control of the product, despite it physically remaining with the entity.
- There may be **a fee for custodial services**, where the entity recognizes a fee for holding the goods on behalf of the customer. This performance obligation would be satisfied over time, **so any revenue would be recognized on this basis**.

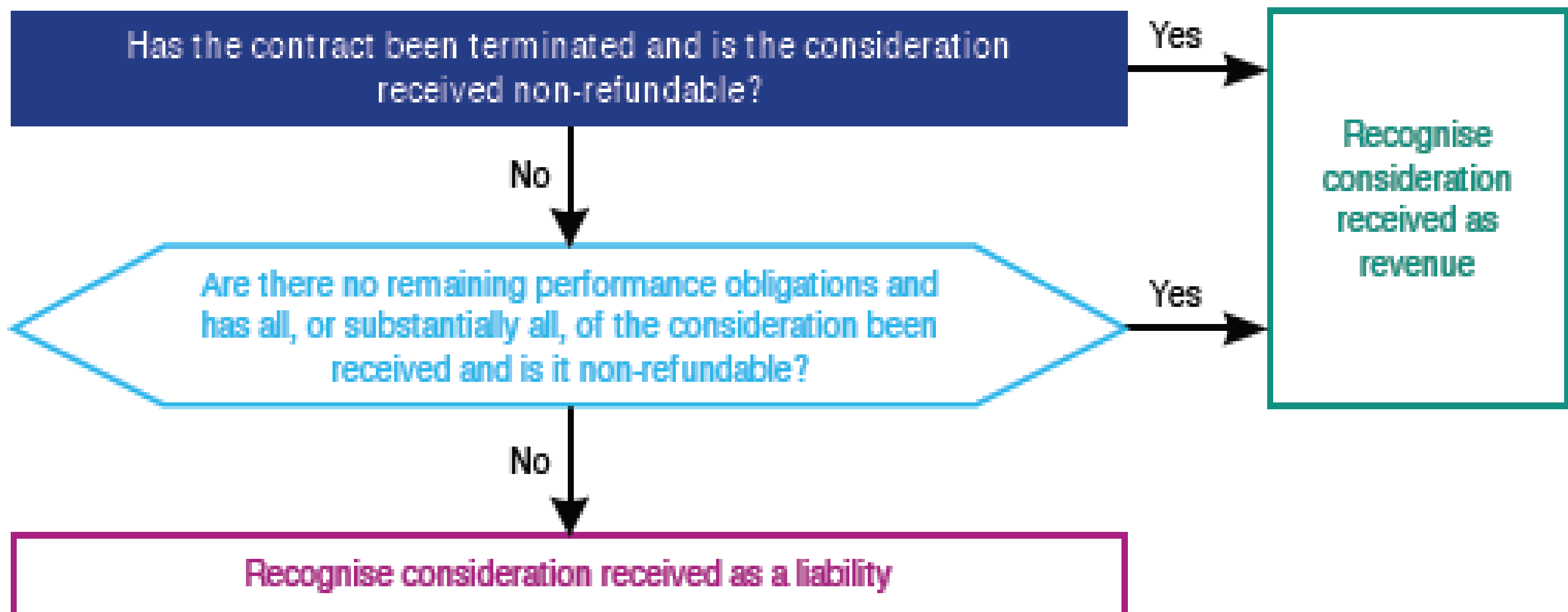
3. Bill and hold old arrangements

- For this to exist:
- The customer must have **requested** the arrangement.
- The product must be identified as **belonging** to the customer.
- The product must be ready for **physical transfer** to the customer.
- The entity cannot have the **ability to use the product or sell it** to someone else.

4. Consideration received before a contract exists

Consideration received before a contract exists

The following flowchart outlines when consideration received from a contract that is not yet in the scope of the standard can be recognised.

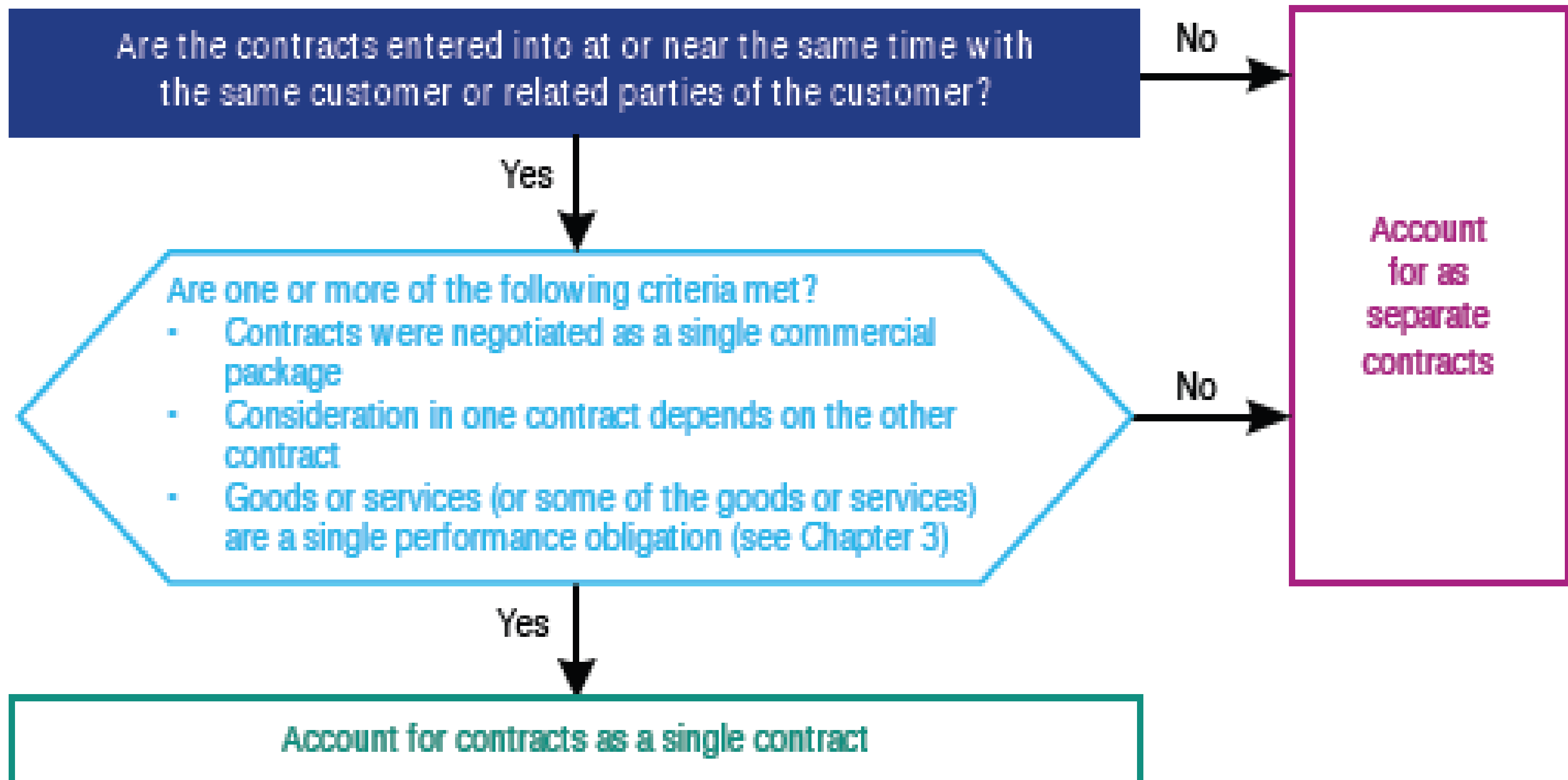


The entity is, however, required to reassess the arrangement and, if Step 1 of the model is subsequently met, begin applying the revenue model to the arrangement.

4. Combination of contracts

Combination of contracts

The following flowchart outlines the criteria in the standard for determining when an entity combines two or more contracts and accounts for them as a single contract.



6. Satisfying a performance obligation over time

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

1. the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs

6. Satisfying a performance obligation over time

2. 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

3. 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.

- For a performance obligation satisfied over time, an entity recognizes revenue over time by **measuring the progress towards complete satisfaction of that performance obligation.**

Appropriate methods of measuring progress include:

- **output methods** (such as surveys of performance (for example the value of the work certified as completed so far compared to the overall contract price), or time elapsed (time spent on the contract compared to total duration)).
- **input methods** (such as costs incurred to date as a proportion of total expected costs).
- ***Revenue will be recognised based on the amount of progress made compared to the total price.***

Contract costs

- IFRS 15 says that the following costs must be capitalized:
  - The incremental costs of obtaining a contract.
  - The costs of fulfilling a contract if they do not fall within the scope of another standard (such as IAS 2 Inventories) and the entity expects them to be recovered.
- The capitalized costs will be amortized as revenue is recognized. This means that they will be expensed to cost of sales as the contract progresses.
- These will be matched to revenue based on either the input or output method of measuring progress. This means cost of sales will be measured as % progress made × total costs.
- For a contract with a customer where revenue is recognized over time, there are three important rules to be aware of:

(1) If the expected outcome is a profit: – revenue and costs should be recognized according to the progress of the contract.

(2) If the expected outcome is a loss:

- the whole loss should be recognized immediately, recording a provision as an onerous contract.

(3) If the expected outcome or progress is unknown (often due to it being in the very early stages of the contract):

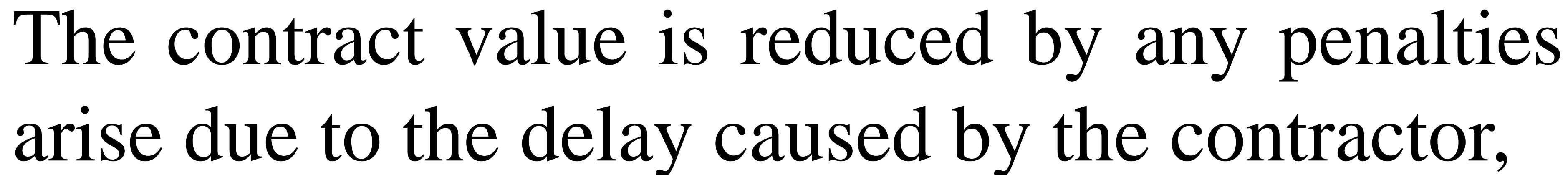
- Revenue should be recognized to the level of recoverable costs (usually costs spent to date).
- Contract costs should be recognized as an expense in the period in which they are incurred.

Contract revenue comprises:

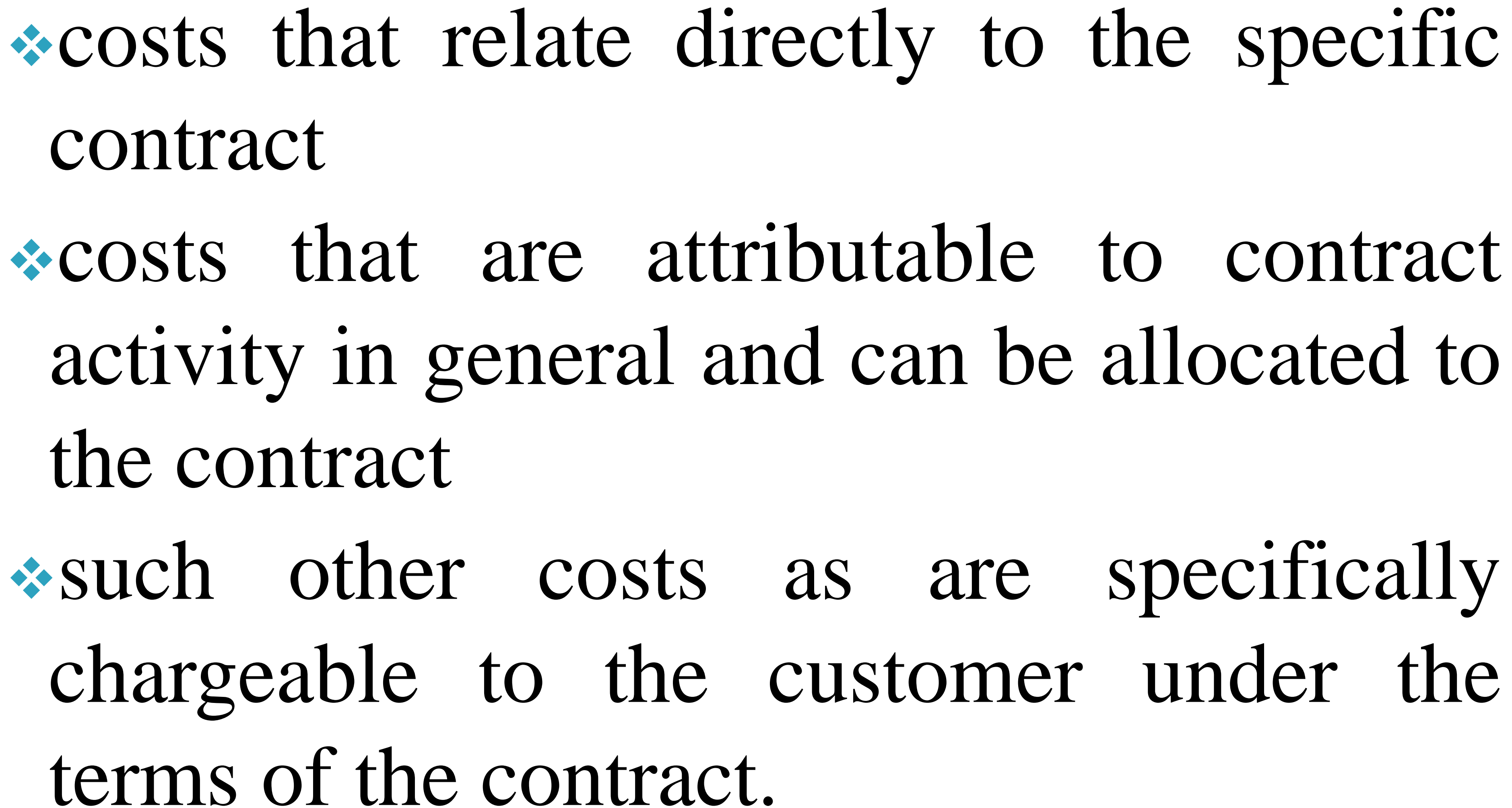
- the initial amount of revenue agreed in the contract
- variations in contract work and claims, to the extent that:
  - it is probable that they will result in revenue
  - they are capable of being reliably measured.
- Claims are amounts that the contractor seeks to reclaim from the customer as reimbursement for costs not included in the contract price. They may arise due to errors in design or customer caused delay.

- incentive payments (additional payments made to the contractor if performance standards are met or exceeded) when
  - the contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
  - the amount of the incentive can be measured reliably.

The contract value is reduced by any penalties arise due to the delay caused by the contractor,



Contract costs



- costs that relate directly to the specific contract
- costs that are attributable to contract activity in general and can be allocated to the contract
- such other costs as are specifically chargeable to the customer under the terms of the contract.

Costs that related directly to specific contract include:

- site labour costs, including site supervision
- costs of materials used in construction
- depreciation of plant and equipment used on the contract
- costs of moving plant, equipment and materials to and from the contract site
- costs of hiring plant and equipment
- costs of design and technical assistance that is directly related to the contract

- the estimated costs of rectification and guarantee work, including expected warranty costs
- claims from third parties.

Costs that may be attributed to contract activities in general and can be allocated to specific contracts include:

- insurance
- costs of design and technical assistance that are not directly related to a specific contract
- construction overheads.

Presentation in the statement of financial position

- As well as the revenue and expenses, there are likely to be contract assets or liabilities. These will depend on the amounts recorded in the statement of profit or loss compared to the cash received or the costs to date.
- In calculating the entries to be made for a contract where the performance obligation is satisfied over time, such as a building project for a customer, a 4step approach can be helpful

Step 1 – Calculate overall profit or loss

	$
Contract price	X
Less: costs to date	(X)
Less: costs to complete	(X)
Overall profit/loss	X/(X)

Step 2 – Determining the progress of a contract

There are two acceptable methods of measuring progress towards satisfying a performance obligation:

- Input methods – based on the inputs used. A commonly used measure looks at contract costs, such as:

  (Costs to date/Total costs) × 100% = % complete

  Output methods – based on performance completed to date. This is commonly done based on the value of the work completed (certified) to date, measured as (Work certified/Contract price) × 100% = % complete.

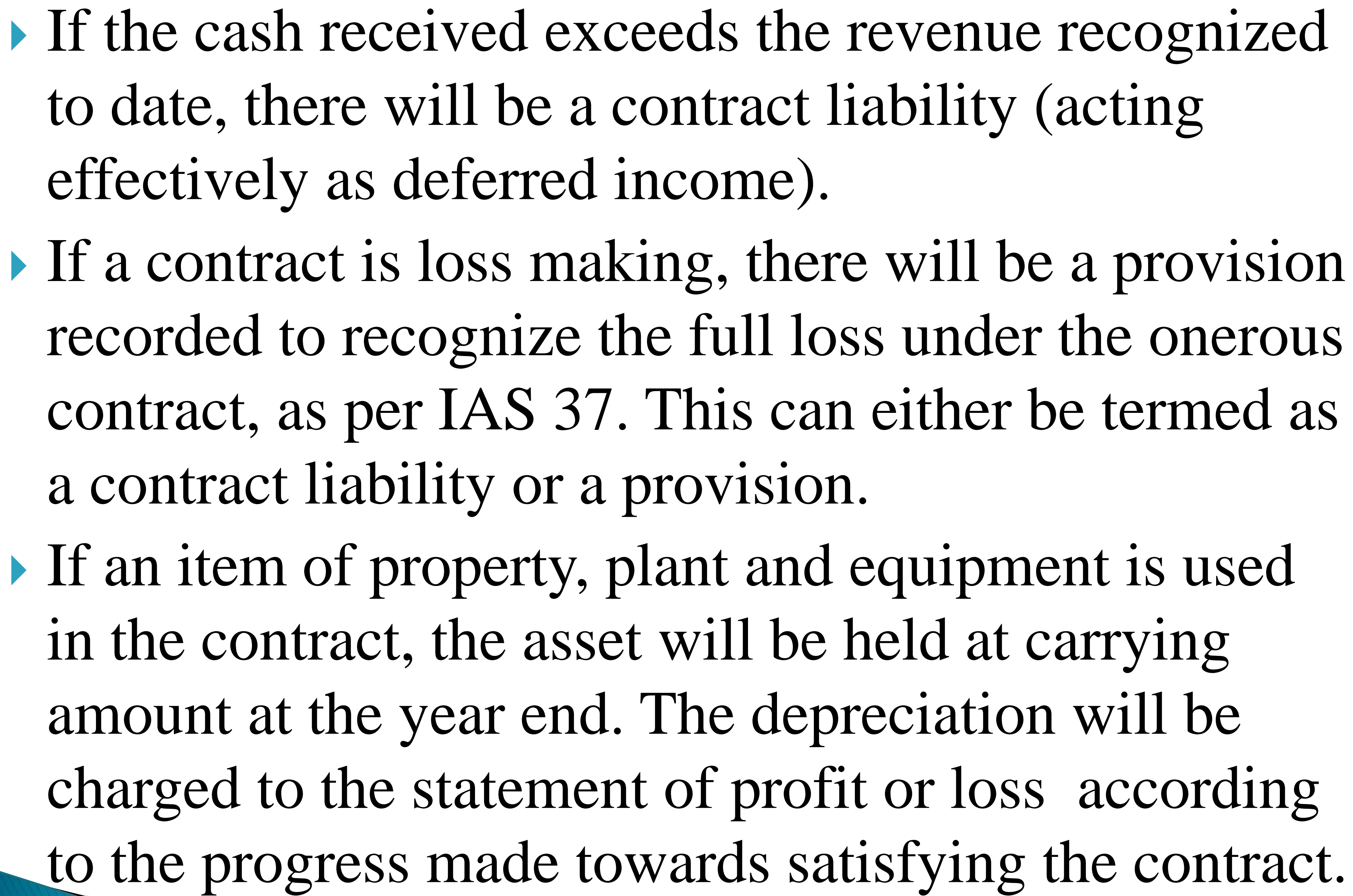
  If revenue is earned equally over time (such as providing a monthly service), then revenue would be recognised on a straight line basis over that period.

Where the progress cannot be measured

- Revenue should be recognised only to the extent of contract costs incurred that it is probable will be recoverable.

Step 3 – Statement of profit or loss (if profitable)

	$
Revenue (Total price × progress (%)) **less** revenue recognised in previous years	X
Cost of sales (Total costs × progress (%)) **less** cost of sales recognised in previous years	(X)
	—
Profit	X
	—


- If the cash received exceeds the revenue recognized to date, there will be a contract liability (acting effectively as deferred income).
- If a contract is loss making, there will be a provision recorded to recognize the full loss under the onerous contract, as per IAS 37. This can either be termed as a contract liability or a provision.
- If an item of property, plant and equipment is used in the contract, the asset will be held at carrying amount at the year end. The depreciation will be charged to the statement of profit or loss according to the progress made towards satisfying the contract.

Presentation

Statement of financial position

- If the revenue recognized exceeds the cash received, there will be a **contract asset**. If the contract costs to date exceed the cost of sales recognized, this will be treated as **work in progress**. This can be included within the contract asset. This will be shown as a separate asset within current assets.

Presentation

Statement of financial position

- As alternatives to the term 'contract asset', IFRS 15 also allows the terms **receivable and work in progress** to be used. If revenue exceeds cash received, this could be included within trade receivables. If costs to date exceed cost of sales, this could be included within inventory, as work in progress.

Disclosure

The following amounts should be disclosed unless they have been presented separately in the financial statements in accordance with other standards.

1. Revenue recognized from contracts with customers (separate from other source of revenue)
2. Any impairment losses recognized on any receivable or contract assets (separate from other impairment)
3. Opening and closing balances of receivables, contract assets and liabilities
4. Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period

5. Revenue recognized in the reporting period from performance obligations satisfied in pervious periods (such as charges in transaction price) Other information that should be provided

6. An explanation of significant changes in the contract asset and liability balances during the reporting period

7. Information regarding the entity's performance obligations

8. Price allocated to the performance obligation that not satisfied

9. Judgments and changes in judgment used to determine amount, timing of revenue from contracts

10. Assets recognised from the costs to obtain or fulfil a contract

Thanks
With al respects