IFRS 15
Revenue from Contracts with Customers

FIA Technical Workshop

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Acknowledgements

This presentation is based on various documents including

- IFRS 15, published by IASB
- IFRS News, Special Edition on Revenue published by Grant Thornton

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Introduction

Core Principle

An entity shall recognise 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

Replaces IAS 18 (Revenue) & IAS 11 (Construction Contracts)

- Effective for accounting periods commencing on 1 January 2018 or later

Scope

Applies to all contracts with customers except

1. Lease contracts within the scope of IFRS 16
2. Contracts within the scope of IFRS 17
   - Entities may apply IFRS 15 to insurance contracts whose primary purpose is to provide services for a fixed fee (IFRS 17 para 8)
3. Financial instruments and other contractual rights or obligations within the scope of IFRS 9, IFRS 10, IFRS 11, IAS 27 and IAS 28
4. Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers e.g. Borrow & Loan

Five Steps for Revenue Recognition

Step	Details
1	Identify the contract(s) with a customer
2	Identify the performance obligations
3	Determine the transaction price
4	Allocate the transaction price to the performance obligations
5	Recognise revenue when or as an entity satisfies performance obligations

Step 1

Identify the Contract(s) with a Customer

Contract

An agreement between 2 or more parties that creates enforceable rights and obligations

- Written, oral or implied by an entity’s customary business practices

IFRS 15 requires all the following criteria to be met

1. The contract has commercial substance
2. The parties have approved the contract
3. The entity can identify each party’s rights; and payment terms for the items to be transferred
4. It is probable that the entity will collect the consideration

Contract

If the preceding criteria are not met

Revenue is recognized only when either:

1. the entity's performance is complete and substantially all the consideration in the arrangement has been collected and is non-refundable; or
2. the contract has been terminated and the consideration received is non-refundable

No contract exists if each party has the unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party/parties

Combining Contracts

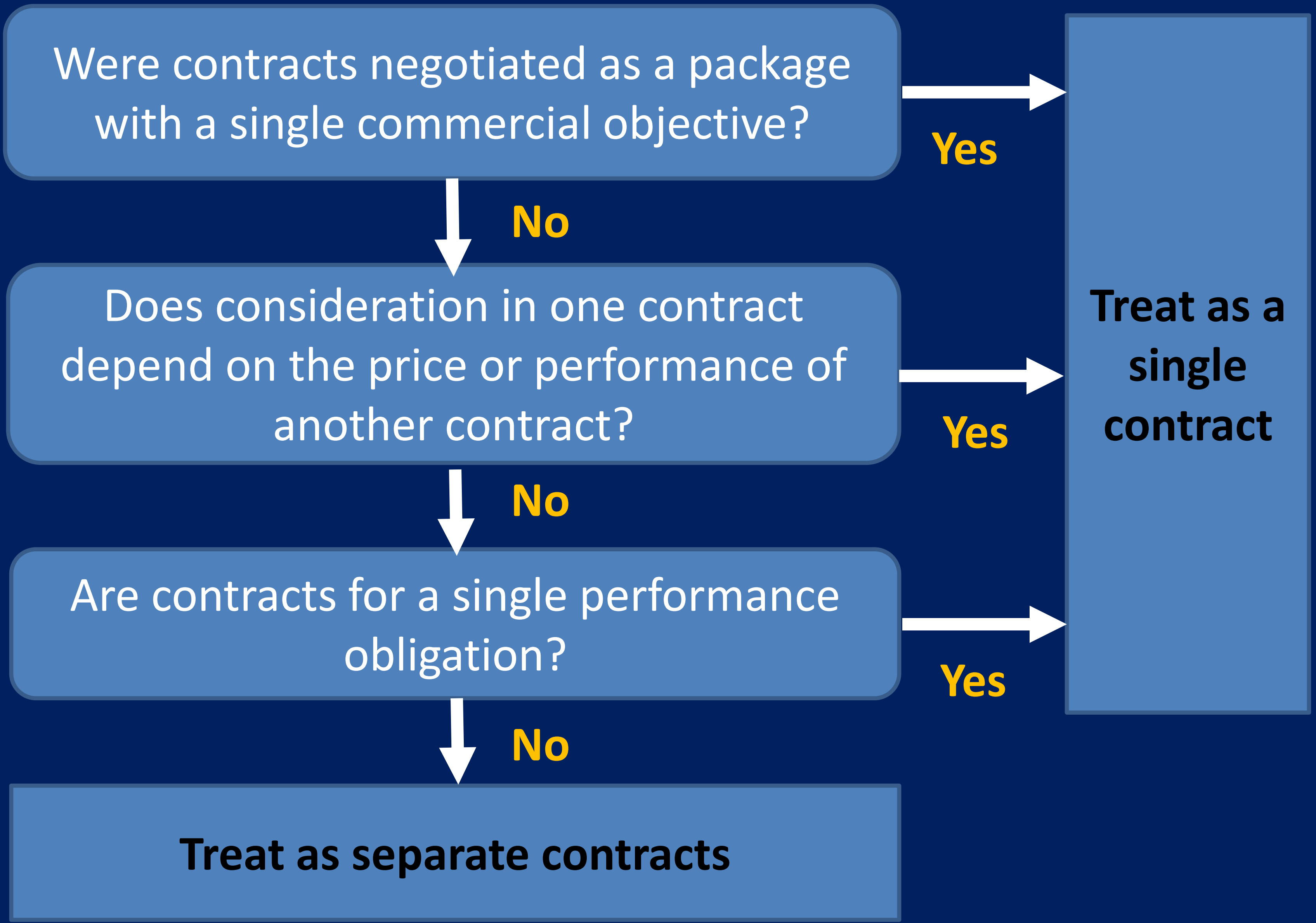
An entity may enter into 2 or more contracts

- with the same customer at or near the same time

Account for them as a single contract if one or more of the following criteria are met:

1. Contracts are negotiated as a package with a single commercial objective;
2. Amount on to be paid in one contract depends on price or performance of the other contract;
3. Goods or services promised in the contracts represent a single performance obligation

Combining Contracts



Step 2

Identify the Performance Obligations

Performance Obligation

A promise in a contract to transfer either:

1. a good or service (or a bundle of goods or services) that is distinct; or
2. a series of distinct goods or services that are substantially the same and meet certain criteria

Exclude administrative-type tasks

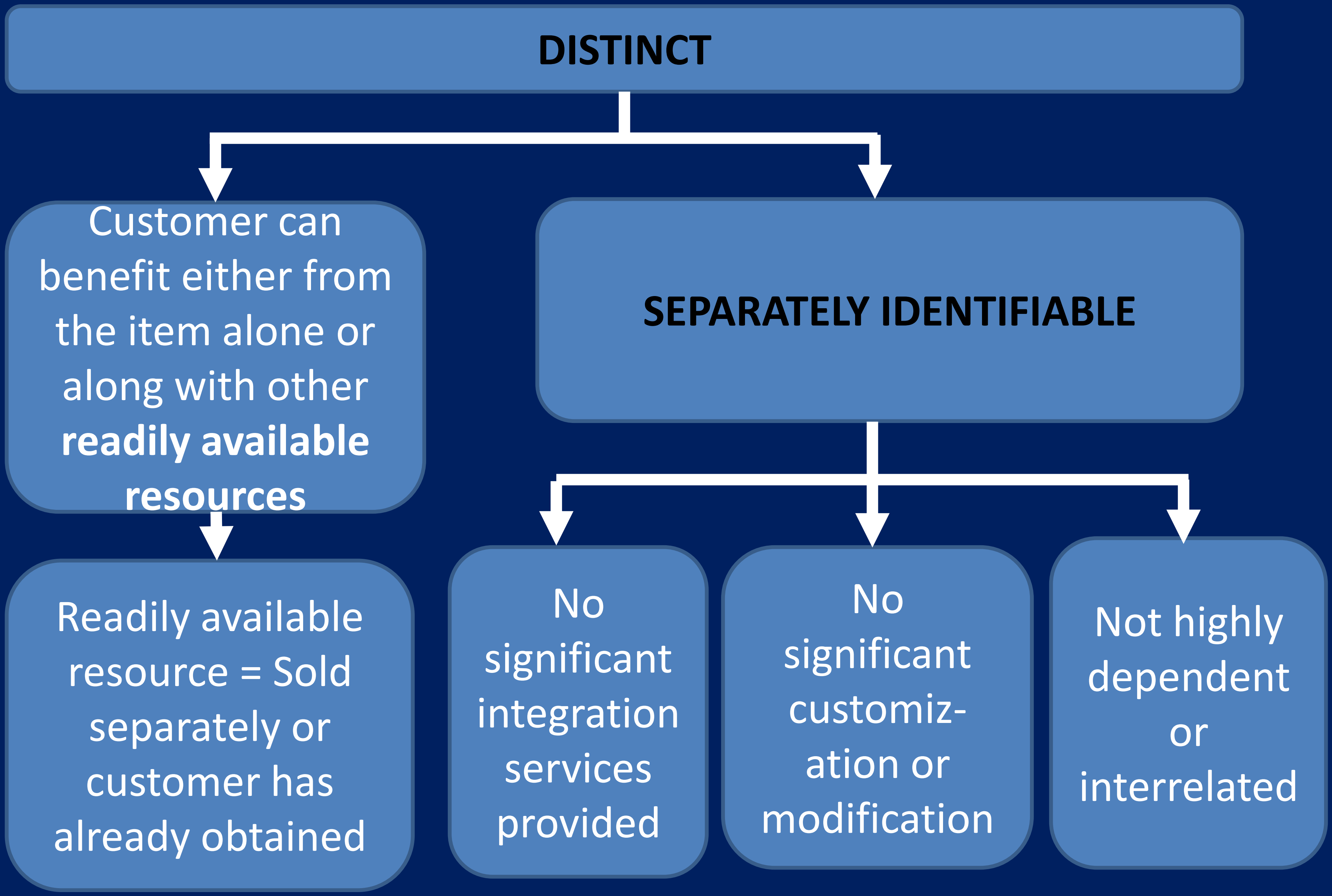
- that don't result in transfer of a good or service to a customer (e.g. some set-up activities).

Distinct Goods or Services

A promised good or service is distinct if both the following are met:

1. the customer can benefit from it either on its own or with other resources readily available to them.
   - A readily available resource is one that is sold separately (by the entity or by another entity) or that the customer has already obtained
2. it is separately identifiable from other promises in the contract
   - i.e. distinct within the context of the contract

Distinct Goods or Services



Step 3

Determine the Transaction Price

The Transaction Price

The amount of consideration an entity expects to be entitled to in exchange for the goods or services promised under a contract

  - exclude any amounts collected on behalf of third parties e.g. sales taxes.

The transaction price is

- not adjusted for effects of the customer's credit risk
- is adjusted if the entity has created a valid expectation that it will enforce its rights for only a portion of the contract price
  - e.g. based on its customary business practices

The Transaction Price

When determining the transaction price, consider the effects of all the following factors :

1. Variable consideration
2. The constraint on variable consideration
3. Time value of money
4. Non-cash consideration
5. Consideration payable to the customer

Variable Consideration

The consideration may vary due to

- discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties etc.

Variable consideration also applies if:

1. consideration is contingent on the occurrence or non-occurrence of a future event
   - e.g. a fixed-price contract would be variable if the contract included a return right
2. the facts and circumstances at inception indicate that the entity intends to offer a price concession

Variable Consideration

To estimate the transaction price, an entity determines either

1. the expected value (sum of probability-weighted amounts) or
2. the most likely amount

of consideration to be received, whichever better predicts the amount to which the entity will be entitled

- Expected value might be appropriate where an entity has a large number of similar contracts.
- The most likely amount might be appropriate if a contract has only two possible outcomes

Constraint on Variable Consideration

When the contract consideration includes a variable component

- an entity must evaluate whether the amount of variable consideration included in the transaction price needs to be constrained
- to ensure that it recognises revenue only to the extent it is highly probable there will not be a significant reversal of revenue when the related uncertainty resolves.

Constraint on Variable Consideration

Factors that could increase the likelihood or the magnitude of a revenue reversal include:

1. the amount of consideration is highly susceptible to factors outside the entity's influence
2. the uncertainty is not expected to be resolved for a long time
3. the entity has limited experience with similar contracts
4. the entity has a practice of offering a broad range of price concessions
5. there are a large number and wide range of possible consideration amounts in the contract

Time Value of Money

If the contract includes a significant financing component

- An entity must reflect the time value of money in its estimate of the transaction price
- To reflect an amount as though the customer paid cash when the items were transferred

To determine significance, consider

1. the difference, if any, between the promised consideration and the cash price
2. the combined effect of
   - the expected length of time between delivery of the goods or services and receipt of payment
   - the prevailing interest rate in the relevant market

Time Value of Money

To adjust for the time value of money, an entity applies the discount rate that would be used in a separate financing transaction with the customer at inception. That rate reflects

- the credit risk of the party receiving credit (i.e. the customer if payment is deferred and the vendor if payment is in advance)
- and any collateral or security provided by the customer or the entity, including assets transferred under the contract.

Present the effects of financing separately from revenue

- as interest expense or interest income in the statement of comprehensive income.

Non-cash Consideration

If a customer promises consideration in a form other than cash

- measure the non-cash consideration at fair value

If an entity is unable to reasonably measure the fair value of non-cash consideration

- measure the consideration indirectly by referring to the stand-alone selling price of the items promised under the contract

Consideration Payable to a Customer

Includes

1. amounts that an entity pays or expects to pay to a customer in the form of cash or non-cash items
2. credit or other items that the customer can apply against amounts owed to the entity.

An entity reduces the transaction price by the amount it owes to the customer

- unless the consideration owed is in exchange for distinct goods or services transferred from the customer to the entity

Consideration Payable to a Customer

An entity recognises any reduction in revenue associated with adjusting the transaction price for consideration payable to a customer at the later of the following

1. the date the entity recognizes revenue for the transfer of goods or services to the customer
2. the date the entity pays or promises to pay the consideration to the customer.

That promise may be implied by the entity's customary business practices.

Consideration Payable to a Customer

Is consideration payable to the customer for a distinct good or service?

Yes

Account for the purchase of distinct good or service similarly to purchases from suppliers

- if consideration owed to the customer > FV of goods/services: *reduce transaction price by that excess*
- if entity cannot estimate FV of goods/services received from customer: *reduce transaction price by total consideration owed to the customer*

No

Reduce the transaction price by the amount owed to the customer at later of when:

Related revenue is recognized

Consideration is paid or promised to customer

Step 4

Allocate the Transaction Price to the Performance Obligations

Allocation

Allocate the transaction price to each separate performance obligation within the contract

- on a relative stand-alone selling price basis at inception i.e. price at which an entity would sell a promised item separately to a customer

The best evidence of the stand-alone selling price is the observable selling price charged by the entity to similar customers and in similar circumstances

- If this is unavailable, estimate it using all reasonably available information (market conditions, entity-specific factors, information about the customer etc), maximising the use of observable inputs

Estimation Methods

	IFRS 15 suggests but doesn't require …
Adjusted market assessment approach	Evaluate the market in which the entity sells and estimate the price that customers in that market would pay for those items. An entity may also consider price information from its competitors and adjust that information for its own costs and margins.
Expected cost plus margin approach	An entity would forecast its expected costs to provide goods or services and add an appropriate margin to the estimated selling price.

Estimation Methods

	IFRS 15 suggests but doesn't require …
Residual approach	Subtract the sum of observable stand-alone selling prices for other items promised under the contract from the total transaction price to arrive at an estimated selling price for a performance obligation. This method is only permitted if the entity: ▪ sells the same good/service to different customers (at or near the same time) for a broad range of amounts; or ▪ has not yet established a price for the item and it has not previously been sold on a stand-alone basis.

Allocating Discounts

If the sum of the stand-alone selling prices for the promised items exceeds the contract's total consideration

- treat the excess as a discount to be allocated to the separate performance obligations on the basis of their relative stand-alone selling prices

Allocate a discount to only some of the performance obligations

- Where there is observable evidence of the obligations to which the entire discount belongs

Step 5

Recognise Revenue When or As an Entity Satisfies Performance Obligations

Revenue Recognition

Recognise revenue when or as the entity transfers promised goods or services to a customer.

- A “transfer” occurs when the customer obtains control of the good or service.
- A customer obtains control of an asset (good or service) when it can direct the use of and obtain substantially all the remaining benefits from it.
  - Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset

Control Transferred Over time

Control is transferred over time if one of the following conditions exists:
1. customer controls the asset **as it is created** or enhanced by the entity's performance under the contract
2. customer **receives and consumes the benefits** of the entity's performance as the entity performs. ▪ This occurs if another entity would not have to substantially re-perform the work completed to date if it stepped in to complete the remaining obligation(s)under the contract

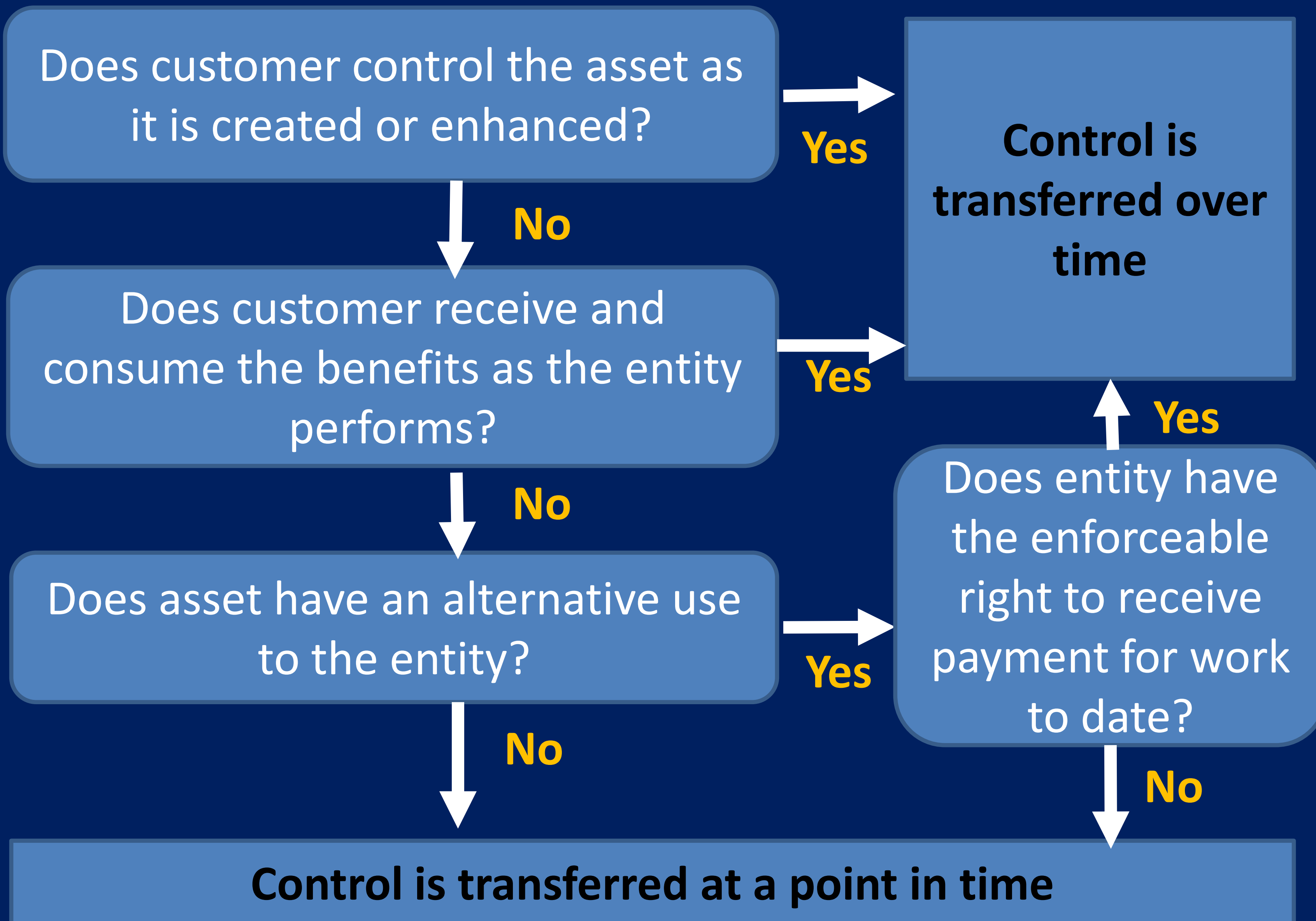
Control Transferred Over time

Control is transferred over time if one of the following conditions exists:

3. the entity's performance creates or enhances an asset that has **no alternative use to the entity**, and it has the **right to receive payment for work performed** to date.

- Consider whether it can readily redirect the partially completed asset to another customer throughout the production process.
- In addition, the **right to payment should be enforceable.** A vendor considers the contractual term and any legislation or legal precedent that could override those terms.

Determining Timing of Transfer



Control Transferred Over Time

To recognise revenue associated with a performance obligation satisfied over time

- measure progress toward completion of that performance obligation
- to depict the pattern by which the entity transfers control of the goods or services to the customer

The entity must update this measurement over time as circumstances change

- account for these changes as a change in accounting estimate under IAS 8

Control Transferred Over Time

Progress toward completion of a performance obligation can be measured using

1. Output Methods

   Revenue recognised by directly measuring the value of the goods or services transferred to date to the customer

2. Input methods

   Revenue recognized based on the extent of efforts or inputs towards satisfying a performance obligation compared to the expected total efforts or inputs needed

Output Methods

Description	Examples
• Revenue could be recognised at amount invoiced only if this corresponds directly with the value of the items transferred to date • The units produced or units delivered method could provide a reasonable proxy for the entity's performance provided any WIP or finished goods controlled by the customer are appropriately included in the measure of progress	Surveys of performance to date, milestones reached or units produced

Input Methods

Description	Examples
It may be appropriate to recognise revenue on a **straight-line basis** if efforts/inputs are expended evenly over the performance period. Adjust the measure of progress for any inputs that do not depict performance ▪ costs incurred that don't contribute to progress e.g. wasted materials ▪ Costs that not proportionate to progress e.g. non-distinct goods procured from another supplier with limited involvement by the entity	Resources consumed, labour hours expended, costs incurred, machine hours used or time lapsed

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