IFRS FOR SMEs

ACCOMPANYING EXAMPLES AND EXERCISES

Based on the 2015 IFRS for SMEs Standard

Examples—financial assets

1. For a long-term loan made to another entity, a receivable is recognised at the **present value of cash receivable** (including interest payments and repayment of principal) from that entity.
2. For goods sold to a customer on short-term credit, a receivable is recognised at the **undiscounted amount of cash receivable** from that entity, which is normally the invoice price.
3. For an item sold to a customer on two-year interest-free credit, a receivable is recognised at the **current cash sale price for that item**. If the current cash sale price is not known, it may be estimated as the present value of the cash receivable discounted using the prevailing market rate(s) of interest for a similar receivable.
4. For a cash purchase of another entity's ordinary shares, the investment is recognised at the **amount of cash paid to acquire the shares.**

Examples—financial liabilities

1. For a loan received from a bank, a payable is recognised initially at the **present value of cash payable to the bank** (for example, including interest payments and repayment of principal).
2. For goods purchased from a supplier on short-term credit, a payable is recognised at the **undiscounted amount owed to the supplier**, which is normally the invoice price.

Section 21 Provisions and Contingencies

Example 1 Future operating losses

An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—there is no past event that obliges the entity to pay out resources.

Conclusion

The entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 27.

Example 2 Onerous contracts

An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. For example, an entity may be contractually required under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—the entity is contractually required to pay out resources for which it will not receive commensurate benefits.

Conclusion

If an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

A restructuring is a programme that is planned and controlled by management and materially changes either the scope of a business undertaken by an entity or the manner in which that business is conducted.

Present obligation as a result of a past obligating event—a constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

(i) the business or part of a business concerned;

(ii) the principal locations affected;

(iii) the location, function and approximate number of employees who will be compensated for terminating their services;

(iv) the expenditures that will be undertaken; and

(v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Conclusion

An entity recognises a provision for restructuring costs only when it has a legal or constructive obligation at the reporting date to carry out the restructuring.

Example 4 Warranties

A manufacturer gives warranties at the time of sale to purchasers of its product.

Under the terms of the contract for sale, the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On the basis of experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event—the obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement—probable for the warranties as a whole.

<u>Conclusion</u>

The entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

Illustration of calculations:

In 20X0, goods are sold for CU1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price.

Consequently, estimated warranty costs are:

CU1,000,000 × 90% × 0 = CU

CU1,000,000 × 6% × 30% = CU

CU1,000,000 × 4% × 70% = CU

Total = CU

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2 and 10 per cent in 20X3, in each case at the end of the period. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 percent for one-year bonds and 7 per cent for two-year and three-year bonds).

Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments (CU)	Discount rate	Discount factor	Present value (CU)
1					
2					
3					
Total					

The entity will recognise a warranty obligation of CU at the end of 20X0 for products sold in 20X0.

Example 5 Refunds policy

A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event—the obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement—probable that a proportion of goods will be returned for refund.

<u>Conclusion</u>

The entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division—no implementation before end of reporting period

On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—there has been no obligating event, and so there is no obligation.

<u>Conclusion</u>

The entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

On 12 December 20X0 the board of an entity decided to close a division making a particular product. On 20 December 20X0 a detailed plan for closing the division was agreed by the board, letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—the obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

An outflow of resources embodying economic benefits in settlement—probable.

<u>Conclusion</u>

The entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division at the reporting date.

Example 9 A court case

A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable:

(a) at 31 December 20X1

Present obligation as a result of a past obligating event—on the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events. Conclusion—no provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

(b) at 31 December 20X2

Present obligation as a result of a past obligating event—on the basis of the evidence available, there is a present obligation. The obligating event is the sale of the product to the customer. An outflow of resources embodying economic benefits in settlement—probable.

<u>Conclusion</u>

A provision is recognised at the best estimate of the amount to settle the obligation at 31 December 20X2, and the expense is recognised in profit or loss. It is not a correction of an error in 20X1 because, on the basis of the evidence available when the 20X1 financial statements were approved, a provision should not have been recognised at that time.

Examples of revenue recognition under the principles in Section 23

The following examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably; it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

SALE OF GOODS

The law in different countries may cause the recognition criteria in Section 23 to be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Consequently, the examples in this appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

Example 1 'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing

The seller recognises revenue when the buyer takes title, provided:

a) it is probable that delivery will be made;
b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;
c) the buyer specifically acknowledges the deferred delivery instructions; and
d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

Example 2 Goods shipped subject to conditions: installation and inspection

The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognized immediately upon the buyer's acceptance of delivery when:

a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae; or
b) the inspection is performed only for the purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

If there is uncertainty about the possibility of return, the seller recognizes revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the buyer from a third party

The seller recognises revenue when the goods are delivered to the buyer.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

The seller generally recognises revenue from such sales when the risks and rewards of ownership have been transferred. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are dispatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

Example 11 Instalment sales, under which the consideration is receivable in instalments

The seller recognises revenue attributable to the sales price, exclusive of interest, at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The seller recognises the interest element as revenue using the effective interest method.

Example 13 Sale with customer loyalty award

An entity sells product A for CU100. Purchasers of product A get an award credit enabling them to buy product B for CU10. The normal selling price of product B is CU18. The entity estimates that 40 per cent of the purchasers of product A will use their award to buy product B at CU10. The normal selling price of product A, after taking into account discounts that are usually offered but that are not available during this promotion, is CU95.

The fair value of the award credit is 40% × [CU18 – CU10] = CU3.20. The entity allocates the total revenue of CU100 between product A and the award credit by reference to their relative fair values of CU95 and CU3.20 respectively.

Consequently:

a) revenue for product A is;

b) revenue for product B is

RENDERING OF SERVICES

Example 14 Installation fees

The seller recognises installation fees as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

Example 15 Servicing fees included in the price of the product

When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

Example 16 Advertising commissions

Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognized by reference to the stage of completion of the project.

Example 17 Insurance agency commissions

Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the agent defers the commission, or part of it, and recognises it as revenue over the period during which the policy is in force.

Example 18 Admission fees

The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

Example 19 Tuition fees

The seller recognises revenue over the period of instruction.

Example 20 Initiation, entrance and membership fees

Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty about its collectability exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

INTEREST, ROYALTIES AND DIVIDENDS

Example 26 Licence fees and royalties

The licensor recognises fees and royalties paid for the use of an entity's assets such as trademarks, patents, software, music copyright, record masters and motion picture films) in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use specified technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations after delivery. Another example is the granting of rights to exhibit a motion picture film in markets in which the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.
