



## IFRS 15 Notes PDF

ACCA SBR Short Notes (Tabani's School of Accountancy)



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## IFRS 15 - Revenue from Contracts with Customers

- IFRS 15 replaces IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31.
- IFRS 15 establishes a single and comprehensive framework which sets out how much revenue is to be recognized, and when.
- Before starting the details about the contracts, first need to discuss about some important definitions and scope of this standard, what is inside and what is outside the scope of this standard.

### Revenue from Contracts with Customer:

#### SCOPE

**REVENUE** is an income arising in the course of an entity's ordinary activities.

INCOME is defined as:

- Increase in economic benefits during the accounting period
- In the form of increase in asset or decrease in liabilities
- That result in an increase in equity.

#### IASB Conceptual Framework

'ORDINARY ACTIVITIES' means normal trading or operating activities.

The transactions of income that are not under the definition of revenue:

- Dividend income and interest income (Refer financial instrument standards).
- Rental Income.
- Sale of non-monetary financial assets, like gain on sale of property, plant and equipment or intangible assets.

### PRACTICE QUESTION 1 (SBR SPECIMEN 2 Q3 (A) (i))

#### CUSTOMERS CONTRACTS

IFRS 15 only applies if the counterparty to the contract is a customer.

A customer is 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.

The following **EXAMPLE** is not the customer contract:

- Counterparties' partners that share risks or do activities together would not be regarded as customers for the purpose of IFRS 15.
- For example: Developing an asset in a collaboration arrangement.

- In such a case they share benefits and an **output of ordinary activities is not provided to the customer.**

*A counterparty to the contract would not be a customer if, for example, the counterparty has contracted with the entity to participate in an activity or process in which the parties to the contract share in the risks and benefits that result from the activity or process (such as developing an asset in a collaboration arrangement) rather than to obtain the output of the entity's ordinary activities.*

### **CUSTOMER CONTRACTS NOT UNDER THE SCOPE OF IFRS 15**

IFRS 15 does not apply to contracts with customers that fall within the scope of other standards.

1. Lease contracts (IFRS16),
2. Insurance contracts (IFRS 4),
3. Financial instruments & other contractual rights/obligations (like guarantees) within the scope of IFRS 9, IFRS 10, IFRS 11, IAS 27 & IAS 28.
4. **Non-monetary exchanges** between entities within the **same business** to facilitate sales to customer/potential customers.

*For example: A contract between two oil companies that agree to an exchange of oil to fulfil demand from their customers in different specified locations on a timely basis.*

#### **EXAMPLE BY IFRS 15**

*Entity A & B are both involved in OIL distribution. Each entity operates in a different geographic locations. IFRS 15 will not apply to a contract between A and B if it was an agreement:*

- *To provide each other with OIL if one entity has surplus and other has a shortage.*
- *To assist each other by providing OIL to each other's customers if the other entity is closer to that customer (e.g. B will provide OIL to one of A's customers, since B's closer to that customer, and A will provide OIL to one of B's customers, since A is closer to that customer)*

#### **Conclusion**

*Each oil company has sold oil to its respective end customer (or potential end customer) and therefore revenue is recognised on that ultimate sale of oil. The scope exclusion prevents both oil companies from also recognising additional revenue (and equivalent cost) from the initial exchange of oil between them.*

## IFRS 15 CORE PRINCIPLE

IFRS 15 establishes a single and comprehensive framework which sets out how much revenue is to be recognised, and when.

IFRS 15 explains 5-step process to decide:

- When to recognise revenue
- How to measure revenue
- How to present revenue
- How to disclose revenue

*The core principle is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the vendor expects to be entitled in exchange for those goods or services.*

## IFRS 15 FIVE STEP PROCESS

IFRS 15 takes a five-step approach to recognise revenue:

1. Identify the **contract**. R&O must be Legal (Written or Verbal)
2. Identify the separate **performance obligations** within a contract
3. Determine the **transaction price** Revenue Recognition Criteria
4. **Allocate the transaction price** to the **performance obligations** in the contract
5. **Recognise** revenue when (or as) a performance obligation is satisfied

## IFRS 15 FIVE STEP PROCESS (MORE DETAIL)

A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:

### **Step 1 – Identify the contract with the customer.**

1. The **contract** has been **approved** by the parties to the contract;
2. **Each party's rights** in relation to the goods or services to be transferred can be **identified**;
3. The **payment terms** for the goods or services to be transferred can be **identified**;
4. The **contract has commercial substance**; and
5. It is **probable** that the **consideration** to which the entity is entitled to in exchange for the goods or services will be collected.

### **Step 2 – Identify the separate performance obligations within a contract.**

***PO is a promise to transfer to the customer a good or service (or a bundle of goods or services) that is distinct***

### **Step 3 – Determine the transaction price.**

***Amount of consideration*** that an entity expects to be entitled to in exchange for the promised goods or services.

### **Step 4 – Allocate the transaction price to the separate performance obligations in the contract**

Where a **contract has distinct performance obligations**, an entity will **allocate the transaction price to the performance obligations** to the relative **standalone selling prices** of the goods or services promised.

***A stand-alone selling price is a price at which an entity would sell a promised good or a service separately to the customer (not in the bundle).***

### **Step 5 – Recognise revenue when (or as) a performance obligation is satisfied**

**Performance obligation is satisfied** by **transferring control** of a promised good or service to the customer, which could occur **over time or at a point in time**.

Revenue Recognition = PO Satisfied = Control pass to customer = 1 point of time OR over the period.

## **PRACTICE QUESTION 3 JOST**

## IFRS 15 – More Details

The five steps of revenue recognition will now be considered in more detail.

### Step 1: Identify the Contract

IFRS 15 says that a **contract is an agreement** between two parties that **creates rights and obligations**.

An **entity can only account for revenue from a contract** if it meets the following criteria (Para 9):

1. The **parties** to the contract have **approved the contract**.
2. Each **party's rights and responsibilities** in relation to the goods or services to be transferred **can be identified**.
3. The **payment terms and conditions** for the goods or services to be transferred **can be identified**.
4. The contract has **commercial substance** (*Risk, timings and or amount of the seller's future cash flows expected to change as a result of contract*)
5. The collection of **an amount of consideration** to which the entity is entitled to in exchange for the goods or services is **probable**.

*A contract can be agreed in writing, verbally, or through other customary business practices.*

### Point 4 – Example (Commercial Substance)

*Revenue should not be recognized if the contract has no commercial substance.*

A contract has commercial substance:

- If seller expect the contract to change the **risk, timings** or **amount** of the entity's future cash flows.
- **To assess a transaction's commercial substance, calculate the PV of the FCF from the contract.**
- **PV takes into account the cash flow (amount), when the payments will occur (timings) and a discount rate that reflect the related risk (risk)**

Example: Barter Transaction = No Commercial Substance = No Revenue Recognition.

*The exchange of non-monetary items where the exchange has no commercial substance.*

Entity A agreeing to deliver OIL to entity B's customer, and entity B agreeing to deliver OIL to entity A's customer

IFRS 15 specifically excluded these transactions, because entities (seller) would otherwise artificially inflate their revenues by continually exchanging equally-valued non-monetary items with one another

Example: Barter Transaction = Commercial Substance = Revenue Recognition.

However, barter transactions are in the scope of IFRS 15 for situations in which the two entities concerned are **not in the same line of business**, or when the exchange is not for the purposes of facilitating sales to customers or potential customers.

Therefore, an **exchange of OIL between a manufacturing company and an OIL refiner would potentially be in scope as long as the contract to exchange oil had commercial substance**

#### Another Example

The swapping of bandwidth capacity by different Internet and phone service providers. By doing so, both entities recognize revenue, when in fact no real revenue generation occurs that would result in a change in profits.

#### Point 5 – Example: Probable Consideration

*It should be **probable** that the entity will **collect the consideration due** under the contract.*

*For **evaluation**, an entity shall consider only the customer's ability and intention to pay that amount of consideration **when it is due.***

#### WHAT IF STEP 1 CONDITIONS (PROBABLE CONSIDERATION) NOT QUALIFY ?

##### **REPORTING**

*Any consideration received in respect of a contract that does not meet the above criteria is recognised as a financial liability (OBLIGATION TO PAY THE CASH).*

##### **EXCEPTION**

The consideration received (PREVIOUSLY RECOGNISED AS A LIABILITY as FL) become **recognized as a revenue** only when either of the following events has occurred:

- The entity has already **received substantially all of the consideration** **OR**
- The **contract has been terminated** and **the amount received is non-refundable**

**REASSESSMENT (If Step one not qualify & exception also not meet)**

Entity must continue to account for the initial deposit (as well as any future payments of principal and interest) as a deposit liability, until such time:

- Customer financing position become specifically clear that entity will recover the consideration owing, or
- Until it has received substantially all of it, or
- Terminated the contract.

**Example**

**X Plc** enters into a contract with Mr. A for the sale of a limousine (Luxury Car) for \$100,000.

Mr. A intends to use the limousine to operate an executive transport service. Mr. A has no experience of executive transport and faces high levels of competition.

Mr. A pays a non-refundable deposit of \$25k, and entered into a financing agreement for the remaining 75%. This is to be paid out of the proceeds of the new business venture.

X Plc can repossess the limousine if Mr. A defaults but cannot seek further compensation.

**Analysis: Identify the contract**

- |                                                                                                      |     |
|------------------------------------------------------------------------------------------------------|-----|
| 1. Have the parties approved the contract and are committed to perform their respective obligations? | Yes |
| 2. Can X Plc identify each party's rights?                                                           | Yes |
| 3. Can X Plc identify the payment terms for the goods and services to be transferred?                | Yes |
| 4. Does the contract have commercial substance?                                                      | Yes |
| 5. Is it probable the supplier will collect the consideration?                                       | No  |

It is not probable that X Plc will collect the consideration because:

- Mr A intends to repay the loan from income derived from a business which faces significant risks (high competition and Mr A's limited experience);
- Mr A lacks other income or assets that could be used to repay the loan; and
- Mr A's liability under the loan is limited because the loan is nonrecourse.

**Conclusion: The contract does not meet the IFRS 15 applicability criteria.**

Any consideration received in respect of a contract that does not meet the criteria is recognised as a liability.

X Plc must recognise the \$25,000 received as a liability until either there it becomes probable that the consideration will be received or until the revenue recognition criteria are met.

## REASSESSMENT

This is where

- X Plc's performance is complete and substantially all of the consideration in the arrangement has been collected or
- the contract has been terminated and the consideration received is non-refundable.

In each case the \$25,000 would be recognised as revenue.

### PRACTICE QUESTION: MINCO Q4

### WHAT IF STEP 1 CONDITIONS QUALIFY (INCLUDING PROBABLE CONSIDERATION) ?

*If a contract with a customer **meets the criteria** an entity shall not reassess of the above criteria **unless** there is an indication of a significant change in facts and circumstances (e.g. significant deterioration of customer's financial standing).*

*Any credit deterioration is accounted for prospectively and relates only to remaining goods or services, therefore revenue already recognised is not reversed.*

### PRACTICE QUESTION: KIKI (SBR SPECIMEN 2 Q5 CASE 1)

### QUESTION 6: PRACTICE QUESTION

## Step 2: Identifying the Separate Performance Obligations within a Contract

Performance obligation is a **PROMISE** to transfer **DISTINCT** goods or services to a customer.

### 1.

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 **(single) distinct** good or service (or bundle of goods or services); **(A single deliverable)**

**OR**

A **series of distinct** goods and services **(Several deliverables)**

### 2.

A good or a service (Single/Several) is **DISTINCT** if both of the following conditions meet:

1. **CAPABLE** of being distinct.

**Customer** can benefit from G/S either:

- On its own OR
- Together with other readily available resources.

#### EXAM WORDINGS

*The customer could purchase each good and service without significantly affecting the other goods and services purchased, there is no dependence upon individual elements of the service.*

**AND**

2. **Distinct within the context of CONTRACT**

**SELLER** = Promised G/S **separately identifiable** from other promises in the contract.

#### EXAM WORDINGS

*The entity (Seller) regularly sells each element of the contract separately and is not providing the significant service of integrating the goods and services.*

#### SUPPORTIVE POINTS (For complex cases)

- **Entity is not using PO (G/S) as integration** (as an input to produce/deliver combined output) [Integration is the act of bringing together smaller components into a single system that functions as one.]
- **The (P/O) G/S is not highly dependent (INTERRELATED)** with other G/S in the contract.

- The (P/O) G/S doesn't significantly modify or customize another goods or services.  
(input to modify output)

**If the goods and service are distinct**, then the reporting entity must split the PO with the identified distinct goods & services (bundle of goods or services)

**If the goods and service are not distinct**, the reporting entity must combine them with other promised goods or service until a bundle of goods or services that is distinct can be identified.

**Example: Performance obligations (1)**

Meta Software Services plc supplies computer aided supplying packages to customers. It has recently signed a contract with Ever Tel Design Ltd to provide a license to use a software package, installation service (which did not involve customising the software package) and technical support for four years.

Meta Connect is not the only company that could install the software and provide technical support.

**Requirement**

Assess & identify the performance obligation(s) in the contract.

**Assessment requires judgment with the consideration of all relevant facts & circumstances**

**Solution**

❖ **Single or Series of distinct services**

- A (single) **distinct** good or service (or bundle of goods or services); **(A single deliverable)**

❖ **Distinct performance obligations**

- Each good or service provided (the provision of the licence, the installation service and the technical support) is **capable of being distinct** because:
  - A **customer** could gain benefit from each either
    - on its own or
    - by obtaining the other goods/services from another supplier.

**AND**

- In the **context of this contract, Meta Connect**

*This is not clear = Promised G/S (the provision of the licence, the installation service and the technical support) separately identifiable with each other.*

**ASSESS WITH THESE CONDITIONS**

- PO (G/S) are not integrating,
- PO (G/S) are not highly interrelated,

- PO (G/S) doesn't modifies another G/S (input to modify output)

Therefore each promise is separately identifiable = distinct

In conclusion, there are three distinct performance obligations in the correct, being:

- (1) Installation of the software
- (2) Provision of the licence
- (3) Provision of technical support

**Example: Performance obligations (2)**

Colossal **Construction plc** has recently signed a contract to build a **warehouse for Supa-Save Ltd.** Colossal Construction is responsible for **designing the building, preparing the site, purchasing raw materials, construction, plumbing, wiring and finishing.**

**Requirement**

Identify the performance obligation(s) in the contract.

**Solution:**

**In the context of this contract, Colossal Construction is contracted to provide a significant service of integrating the inputs in order to produce a single output;** this being the warehouse.

Therefore the provision of each good or service is not separately identifiable.

The promises are not distinct and therefore there is only a single performance obligation, being the development of the property.

**Question 7:**

**March/June 2019 (Q4)**

**Zedtech**

## Step 3: Determining the transaction price

*This is the **amount of consideration in a contract** to which an entity expects in exchange for **satisfying a performance obligation**. Sales tax is excluded.*

This may include both **fixed and variable** elements (but not amounts collected on behalf of third parties).

The transaction price is **affected by the nature, timing and amount of consideration promised by a customer**.

**When determining the transaction price, the following must be considered:**

- **Consideration Fixed + Variable (Complication with Variable)**
- **Significant financing components – Time value of Money**
- **Non-cash consideration -**
- **Consideration payable to a customer - IMTIAZ**

### Variable Consideration

**The amount of consideration for the sale of goods and services might be variable.** This could be due to a number of factors including:

- Discounts
- Refunds
- Price Concessions
- Incentives
- Penalties
- Bonuses

### VC = E+D

The entity must **estimate** the variable consideration and **decide** whether or not to include it in the transaction price.

### Estimate

Variable consideration is included in the transaction price based on either:

- Expected Value – **Probability Analysis** (If large number of contracts with similar characteristics) **OR**

- Single most likely amount – **Y/N** (If contract has only two possible outcomes e.g. achieve performance bonus or not)

***The chosen approach should be that which is expected to provide a better prediction of the consideration = JUDGEMENT***

### **Decide**

IFRS 15 says, Variable Consideration *can only be included in the transaction price if it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty is resolved.*

**In other words variable consideration should only be included if it can be estimated and it is highly probable that the supplier/seller will earn the amount after all uncertainties are resolved.**

### **VARIABLE CONSIDERATION - BONUSES**

#### **Example**

On 1 December 20X1, Bristow provides a service to a customer for the next 12 months. The consideration is \$12 million. Bristow is entitled to an extra \$3 million (BONUS) if, after twelve months, the number of mistakes made falls below a certain threshold.

#### **Required:**

Discuss the accounting treatment of the above in Bristow's financial statements for the year ended 31 December 20X1 if:

1. Bristow has experience of providing identical services in the past = E and it is highly probable that the number of mistakes made will fall below the acceptable threshold = D
2. Bristow has no experience of providing this service = E and **is unsure if the number of mistakes made will fall below the threshold D.**

#### **Solution.**

The \$12 million consideration is fixed.

The \$3 million consideration that is dependent on the number of mistakes made is variable.

Bristow must **estimate** the variable consideration. It could use an expected value or a most likely amount. Since there are only two outcomes, \$0 or \$3 million, then a most likely amount would better predict the entitled consideration.

### CASE 1

Bristow expects to hit the target. Using a most likely amount, the variable consideration would be valued at \$3 million.

Bristow must then **decide** whether to include the estimate of variable consideration in the transaction price.

Based on past experience, it seems highly probable that a significant reversal in revenue recognized would not occur. **This means that the transaction price is \$15 million (\$12m + \$3m).**

As a service, it is likely that the performance obligation would be satisfied over time. The revenue recognized in the year ended 31 December 20X1 would therefore be \$1.25 million ( $\$15m \times 1/12$ ).

### CASE 2

Depending on the estimated likelihood of hitting the target, the variable consideration would either be estimated to be \$0 or \$3 million.

#### Decide

Whatever the amount, the estimated variable consideration cannot be included in the transaction price because it is not highly probable that a significant reversal in revenue would not occur. This is because Bristow has no experience of providing this service. Therefore, the transaction price is \$12 million.

As a service, it is likely that the performance obligation would be satisfied over time. The revenue recognized in the year ended 31 December 20X1 would be \$1 million ( $\$12m \times 1/12$ ).

IAFRS 15 SAYS, Both the likelihood and magnitude of revenue reversal should be considered when assessing the probability. Factors that increase the likelihood or magnitude include.

- A high likelihood that the variable consideration will change due to factors that cannot be influenced by the entity – **EXTERNAL FACTORS (e.g. market performance);**
- A **long period of uncertainty** about the variable consideration before it is expected to be resolved;

- Limited **experience** with similar types of contracts;
- A practice of offering a wide range of variable terms or a **history of changing variable** terms in similar circumstances;

### **VARIABLE CONSIDERATION – REFUNDS/RIGHTS OF RETURNS**

If a product is sold with a **right to return** it then the **consideration is variable**.

The entity must **estimate** the variable consideration and **decide** whether or not to include it in the transaction price.

**An entity recognises a refund liability** if it receives consideration from a customer and expects to refund some or all of that consideration to the customer. A refund liability is measured at the amount of consideration received (or receivable) for which the entity does not expect to be entitled.

#### **Example**

Nardone enters into 50 contracts with customers. Each contract includes the sale of one product for \$1,000. The cost to Nardone of each product is \$400. Cash is received upfront and control of the product transfers on delivery. **Customers can return the product within 30 days to receive a full refund. Nardone can sell the returned products at a profit.**

Nardone has significant experience in estimating returns for this product. It estimates that 48 products will not be returned.

#### **Required:**

How should the above transaction be accounted for?

#### **Solution:**

The fact that the customer can return the product means that the consideration is **variable**.

E

Using an expected value method, the estimated variable consideration is \$48,000 (48 products × \$1,000).

D

The variable consideration should be included in the transaction price because, based on Nardone's experience, it is highly probable that a significant reversal in the cumulative amount of revenue recognized (\$48,000) will not occur.

Therefore, revenue of \$48,000 and a refund liability of \$2,000 ( $\$1,000 \times 2$  products expected to be returned) should be recognized.

Nardone will derecognize the inventory transferred to its customers. However, it should recognise an asset of \$800 ( $2 \text{ products} \times \$400$ ), as well as a corresponding credit to cost of sales, for its right to recover products from customers on settling the refund liability.

|                                    |          |
|------------------------------------|----------|
| DR. COST OF SALES                  | 48 UNITS |
| DR. RIGHT TO RECOVER FROM CUSTOMER | 02 UNITS |
| CR. INVENTORY                      | 50 UNITS |

|               |          |
|---------------|----------|
| DR. BANK      | 50 UNITS |
| CR. REVENUE   | 48 UNITS |
| CR. LIABILITY | 02 UNITS |

*Note that if a product is sold with a right to return it then the consideration is variable. The refund liability should equal the consideration received (or receivable) that the entity does not expect to be entitled to.*

### **VARIABLE CONSIDERATION – THE PRICE CONCESSION**

#### **Example**

On 1 July 20X8, Danmar construction plc (Danmar) signed a contract to build an extension to a retail outlet. The total price agreed is found £80 million. The contract terms require Completion by 31 March 20X9.

The price will decrease by £200,000 for every day after this date that the project remains incomplete. At the year end of 31 December 20X8, Danmar expects that there is an 80% chance of the project being completed on time, a 10% chance of its being completed a day late, a 7% chance of it being completed two days late in a 3% chance of it being completed 3 days late.

#### **Requirement**

What is the transaction price?

## Solution

The consideration is variable due to the fact that Danmar will accept an amount that is less than the price stated in the contract if the project overruns (The price concession).

Hear the calculation of transaction prices based on expected values.

|                   | £                 |
|-------------------|-------------------|
| 80% x £80,000,000 | 64,000,000        |
| 10% x £79,800,000 | 7,980,000         |
| 7% x £79,600,000  | 5,572,000         |
| 3% x £79,400,000  | <u>2,382,000</u>  |
| Transaction Price | <u>79,934,000</u> |

### **VARIABLE CONSIDERATION – Penalty gives rise to variable consideration**

An entity enters into a contract with a customer to build an asset for CU1 million. In addition, the terms of the contract include a penalty of CU100,000 if the construction is not completed within these months of a date specified in the contract.

The entity concludes that the consideration promised in the contract includes a fixed amount of CU900,000 and a variable amount of CU100,000 (arising from the penalty).

The entity estimates the variable consideration in accordance with paragraphs

50-54 of IFRS 15 and considers the requirements in paragraphs 56-58 of IFRS 15 on constraining estimates of variable consideration.

### **VARIABLE CONSIDERATION INCENTIVES & PENALTIES – IFRS EXAMPLE 21**

#### **More Example of IFRS 15**

**VARIABLE CONSIDERATION – VOLUME DISCOUNT**

Bellway has a contract to supply components to a customer on a monthly basis.

The contract price of \$6 per unit is reduced to \$5 per unit if the customer orders more than 10,000 units during the calendar year.

The customer ordered 1,200 units in the month of January.

Bellway has significant experience with this product and the purchasing patterns of this customer.

Bellway estimates that the customer's purchases will exceed the 10,000-unit threshold and concludes that it is highly probable that a significant reversal in the amount of revenue recognized will not occur when the total amount of purchases by the customer is known at year end.

Bellway will recognize revenue of \$6,000 (1,200 units × \$5 per unit) for the goods sold in January, as this is the most likely outcome for the year.

If at any time during the year it appears that the total number of units ordered for the year will be less than 10,000, Bellway should change the amount of revenue previously recognized (RETROSPECTIVELY) to reflect the higher (non-discounted) price.

**VARIABLE CONSIDERATION – VOLUME DISCOUNT IFRS Example 24**

## Financing

In determining the transaction price, an entity must consider if the timing of payments provides the customer or the entity with a financing benefit.

IFRS 15 provides the following indications of a significant financing component:

- 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.

If there is a financing component, then the consideration receivable needs to be discounted to present value using the rate at which the customer borrows money.

Where an extended period of credit is offered, the revenue has two separate components:

- The value of the goods/services on the date of sale
- Finance Income

For the working of present value the discount rate equals to market rate of interest (considering the credit rating situation of the customer)

The effect on the timing of the revenue recognition is that:

- Fair Value of the goods is recognized on the delivery of the goods
- The finance income is recognized over the period that financing is provided.

**Example**

Rudd enters into a contract with a customer to sell equipment on 31 December 20X1. Control of the equipment transfers to the customer on that date. The price stated in the contract is \$1m and is due on 31 December 20X3.

Market rates of interest available to this particular customer are 10%.

**Required:**

Explain how this transaction should be accounted for in the financial statements of Rudd for the year ended 31 December 20X1.

**SOLUTION**

Due to the length of time between the **transfer of control of the asset – Revenue Recognition and the payment date**, this contract includes a significant financing component.

The consideration must be adjusted for the impact of the financing transaction.

**A discount rate should be used that reflects the characteristics of the customer i.e.10%. (Market and Customer Credit Rating)**

Revenue should be recognised when the performance obligation is satisfied.

As such revenue, and a corresponding receivable, should be recognized at \$826,446 ( $\$1\text{m} \times 1/1.102$ ) on 31 December 20X1.

Dr F.A  
Cr. Revenue

**Subsequently**

The receivable is subsequently accounted for in accordance with IFRS 9 *Financial Instruments*. FA by Amortised cost method.

## Non-cash consideration

Transaction where contract mention that seller will receive from the customer for goods and services some non-cash consideration (e.g. shares).

Transaction Price - Measurement:

### 1. Direct Measurement = PREFERABLE

The revenue transaction is measured at the **fair value of the non-cash consideration** like the fair value of share at transaction date.

### 2. Indirect Measurement = IF DM NOT POSSIBLE

If fair value of non-cash transaction cannot be reasonably estimated, the consideration should be measured indirectly by reference to the **stand-alone selling price of the goods or services** promised to the customer.

The entity must not incorporate any subsequent changes in the fair value of the non-cash consideration received (fair value changes in the share price) in the revenue.

*A customer might contribute goods or services (for example, materials, equipment or labour) to facilitate the fulfilment of a contract. Contributed goods or services must be accounted for as non-cash consideration if the supplier obtains control of those contributed goods or services. (Dr Asset/expense Cr Revenue).*

### Example – Direct Measurement

Dan sells a good to Stan. Control over the good is transferred on 1 January 20X1. The consideration received by Dan is **1,000 shares in Stan with a fair value of \$4 each**. By 31 December 20X1, the shares in Stan have a fair value of \$5 each.

### **Required:**

How much revenue should be recognized from this transaction in the financial statements of Stan for the year ended 31 December 20X1?

## Solution

The contract contains a single performance obligation.

**TRANSACTION PRICE** = Consideration for the transaction is non-cash. Non-cash consideration is measured at fair value.

**INITIAL RECOGNITION** = Revenue should be recognised at \$4,000 (1,000 shares × \$4) on 1 January 20X1.

**SUBSEQUENT MEASUREMENT** = Any subsequent change in the fair value of the shares received is not recognised within revenue but instead accounted for in accordance with IFRS 9 *Financial Instruments*.

## **Consideration Payable to a Customer**

Consideration payable to customer include:

*Assuming that (if) 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**.*

*If consideration is paid to a customer in exchange for a **distinct good or service**, then it should be **accounted for as a purchase transaction (NO ADJUSTMENT WITH SALES REVENUE)***

**Golden Gate** enters into a contract with a major chain of **retail stores**. The customer commits to buy at least **\$20m** of products over the next 12 months. The terms of the contract require Golden Gate to make a payment of **\$1m to compensate the customer** for charges that it will need to make to its retail stores to accommodate the products.

By the 31 December 20X1, Golden Gate has transferred products with a sales value of \$4m to the customer.

## **Required**

How much revenue should be recognized by Golden Gate in the year ended 31 December 20X1?

**Solution**

**The payment made to the customer (\$1M) is not in exchange for a distinct good or service. Therefore, the \$1m paid to the customer must be treated as a reduction in the transaction price.**

The total transaction price is essentially being reduced by 5% (\$1m/ \$20m). Therefore, Golden Gate reduces the price allocated to each good by 5% as it is transferred.

By 31 December 20X1, Golden Gate should have recognized revenue of \$3.8m ( $\$4m \times 95\%$ ).

|                  |            |
|------------------|------------|
| <b>BANK/DEBT</b> | <b>4</b>   |
| <b>REVENUE</b>   | <b>3.8</b> |
| <b>LIAB</b>      | <b>0.2</b> |

## **Step 4: Allocate the transaction price to the performance obligation**

The total **transaction price** is allocated to each **performance obligation** in proportion to **stand-alone selling price** of distinct goods and services promised in the contract determined at the inception of the contract.

The **objective** is to allocate the transaction price to each performance obligation in an amount to which the supplier- (seller) expects to be entitled for transferring the promised goods or services to the customer.

DEFINATION: A **stand-alone selling price** is the price at which an entity would sell a promised good or service separately to a customer.

If a contract has only **one performance obligation** the entire transaction price belongs to it  
But

if the entity enters into a contract involves **more than one performance obligation** to be satisfied then the transaction price will have to be allocated to each performance obligation.

The allocation shall be made in such a way that revenue is recognised with fairness upon satisfaction of performance obligations.

**The best evidence of a stand-alone selling price is the observable price (IFRS 13) when the good or service is sold separately.**

### **Example: Performance obligations and Transaction Price**

Meta Connect Software Services plc (Meta Connnect) supplies computer aided supplying packages to customers. It has recently signed a contract with Ever Tel Design Ltd to provide a license to use a software package, installation service (which did not involve customising the software package) and technical support for four years.

**Meta Connect is not the only company that could install the software and provide technical support.**

#### **Requirement 1**

Identify the performance obligation(s) in the contract.

**Solution**

Each good or service provided (the provision of the licence, the installation service and the technical support) is **capable of being distinct** because a **customer** could gain benefit from each either on its own or by obtaining the other goods/services from another supplier.

The good or service could therefore provide benefit (**supplier**) to the customer either on its own or together with other resources that are readily available.

In the context of this contract, Meta Connect is not integrating the goods or services, none of the goods or services modifies another and the goods/services are not highly interrelated. Therefore each promise is separately identifiable. There the promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

In conclusion, there are three **distinct performance obligations** in the contract, being:

- (1) Installation of the software
- (2) Provision of the licence
- (3) Provision of technical support

**Example Continued**

The contract between MetaConnect and EverTel Design is priced at **£6,000**.

The stand-alone selling prices (**LEVEL 1**) of each element are as follows:

|                                |                                    |
|--------------------------------|------------------------------------|
| Provision of a license         | \$5,000                            |
| Installation Service           | \$1,500                            |
| Provision of technical support | \$3,000                            |
| <b>Total</b>                   | <b>\$9,500 = Stand Alone Price</b> |

**Requirement**

Allocate the transaction price to the performance obligation.

**Solution**

License Provision  $5000/9,500 * 6,000 = 3,158$   
 Installation Service  $1500/9,500 * 6000 = 947$   
 Technical Support Service  $3000/9500 * 6000 = 1,895$

Above price allocates the discount component with transaction price.

**If a stand-alone selling price is not directly observable then it must be estimated.**

**To estimate the fair value of stand-alone selling price, the Observable inputs should be maximised (LEVEL 2) whenever possible.**

**Example**

Shred sells a machine and one year's free technical support for \$100,000.

The sale of the machine and the provision of technical support have been identified as separate performance obligations.

Shred usually sells the machine for \$95,000 but it has not yet started selling technical support for this machine as a standalone product.

Other support services offered by Shred attract a markup of 50%. It is expected that the technical support will cost Shred \$20,000.

**Required:**

How much of the transaction price should be allocated to the machine and how much should be allocated to the technical support?

**Solution**

The selling price of the machine is \$95,000 based on observable evidence.

There is no observable selling price for the technical support. Therefore, the standalone selling price needs to be estimated.

A residual approach would attribute \$5,000 ( $\$100,000 - \$95,000$ ) to the technical support. However, this does not approximate the standalone selling price of similar services (which normally make a profit).

A better approach for estimating the selling price of the support would be an expected cost plus a margin (or markup) approach. Based on this, the selling price of the service would be \$30,000 ( $\$20,000 \times 150\%$ ).

The total of **standalone selling prices** of the machine and support is \$125,000 (**\$95,000 + \$30,000**). However, total consideration receivable is only \$100,000. This means that the customer is receiving a discount for purchasing a bundle of goods and services of 20% ( $\$25,000 / \$125,000$ ).

IFRS 15 assumes that discounts relate to all performance obligations within a contract, unless evidence exists to the contrary.

The transaction price allocated to the machine is \$76,000 ( $\$95,000 \times 80\%$ ).

The transaction price allocated to the technical support is \$24,000 ( $\$30,000 \times 80\%$ ).

The revenue will be recognized when (or as) the performance obligations are satisfied.

If a customer is offered a discount for purchasing a **bundle of goods and services**, then the discount should be allocated across all performance obligations within the contract in proportion to their stand-alone selling prices (unless observable evidence suggests that this would be inaccurate).

**Example – Emile woolf**

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## Step 5: Recognise Revenue when (or as) Performance Obligation is Satisfied

Revenue is only recognized when (or as) an **entity satisfies** (discharge) the **performance obligation** by transferring a promised **good** or **service** to a customer.

- PO SATISFIED - CONTROL
- CONTROL TRANSFER TO CUSTOMER = ABLE TO DIRECT + NOT RESTRICTION
- PO SATISFIED
  - DETERMINE = ONE POINT OR OVER THE TIME
  - HOW TO RECOGNISE = ONE POINT OR OVER THE TIME

A performance obligation is satisfied when **control** of the good or services specified in the contract is **transferred** to the customer.

**Control** of an asset means:

- **Ability to direct** the use and **obtain** substantially all of the **benefits** from the asset and
- **Ability to prevent other entities** from **obtaining benefits** from an asset.

### The **Benefits** of an Asset

The benefits of an asset are the potential cash flows (inflows or savings of outflows) that can be obtained directly or indirectly, such as by:

- Using the asset to **produce** goods or provide services (Machinery to produce output)
- Using the asset to **enhance** the value of other assets (Machinery to curve wood)
- Using the asset to settle liabilities or **reduce expenses** (Solar energy battery cells)
- **Selling** or exchanging the asset
- **Pledging** the asset to secure a loan
- **Holding** the asset. (Capital appreciation)

The following **events** can indicate that **control has been transferred**:

- The entity (Seller) 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 significant **risks and rewards** of ownership of the asset have been transferred to the customer
- The customer has **accepted** the asset.

A performance obligation can be satisfied (discharge) either:

1. At a point in time (Eg Retail Sales) OR
2. Over the Time (Eg. Construction Contract)

An entity must **determine at contract inception** whether it satisfies the performance obligation **over time** or **at a point in time**.

### Revenue Recognition: Over the Time (SEA)

A performance obligation satisfied over time and recognises revenue over time, if any one of the following criteria meets:

- (a) The customer **simultaneously receives and consumes** the benefits provided by the entity's performance as the entity performs (for example, maintenance service contracts) or
- (b) The entity's (seller) performance creates or **enhances an asset that the customer controls** as the asset is created or enhanced, (for example, work in progress on a factory building at the customer's premises) or
- (c) The entity's (seller) performance **does not create an asset with an alternative use** to the entity (Seller) and the entity (seller) has an **enforceable right (YES) to payment for performance completed to date** (for example, contract to construct a building as per customer design)

*NOTE: from the above criteria it can be noticed that the customer in addition to the ability to receive benefits from goods or services should have an ability to prevent others from directing use of the asset under the contract.*

### **Revenue Recognition: At a Point in Time**

When it has been assessed that performance obligations under the contract with the customer **do not satisfy over time** (with the consideration of all above conditions), an entity shall recognize revenue when **performance obligation is satisfied at a point in time**.

In simple words, if none of the criteria for control transfer over time exist at the inception of contract only then control transfer and revenue recognition at a point in time.

#### ***Note:***

*Events that may indicate that contract has transferred also discussed above.*

### **Revenue Recognition**

#### **In case of satisfaction of performance obligation at a point in time**

All the transaction price allocated to the performance obligation satisfied will be recognized immediately (NOW OR AT THE END OF CONTRACT)

#### **In case of satisfaction of performance obligation over time**

Revenue from the satisfaction of a performance of obligation under a contract and services will have to be recognized in accordance with the extent of performance obligation satisfied (work completed)

The extent shall be measured using:

1. **Output Method** ( Measuring the value to the customer of goods/services transferred to date, like surveys of performance completed to date)
2. **Input Method** (Measuring the cost to the entity efforts or inputs to the performance obligation related to goods/services transferred to date, like cost incurred to date, resources consumed)

Example Frizco Construction (ICAEW):

## **OTHER POINTS**

### **Contract Costs**

IFRS 15 says that the **following costs TREATMENT:**

- **The costs of obtaining a contract.**

#### **EXPENSE OUT IMMEDIATELY**

This must **exclude costs** that would have been incurred regardless of whether the contract was obtained or not (such as some legal fees, or the costs of travelling to a tender).

- **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 capitalised costs of **obtaining and fulfilling** a contract will be **amortised to the statement of profit or loss as revenue is recognised**.

### **Presentation on the statement of financial position**

*Contract Asset or Receivable: When the entity has performed obligation but has not received related consideration, then recognize the contract asset or receivable:*

#### **ASSET**

*Contract Asset = Revenue earned but not yet invoiced (Rights is Conditional) OR*

*Receivable = When revenue has been invoiced = Rights is Unconditional*

*An entity has an unconditional right to receive consideration if only the passage of time is required before payment is due.*

#### **LIAB.**

*Contract Liability: If the entity has received consideration (or has an unconditional right to receive consideration) before the performance obligation by transferring control of goods or services.*

### **Disclosures**

IFRS 15 requires an entity to disclose:

- revenue recognised from contracts with customers
- contract balances and assets recognised from costs incurred obtaining or fulfilling contracts
- significant judgements used, and any changes in judgements.

## Judgement

Management judgement is required throughout all five steps of revenue recognition. For example:

- Contracts with customers do not need to be in writing but may arise through customary business practice. An entity must therefore ascertain whether it has a constructive obligation to deliver a good or service to a customer.
- A contract can only be accounted for if it is probable that the entity will collect the consideration that it is entitled to. Whether benefits are probable is, ultimately, a judgement.
- The entity must identify distinct performance obligations in a contract. However, past performance may give rise to expectations in a customer that goods or services not specified in the contract will be transferred. The identification of distinct performance obligations thus relies on management judgement about both contract terms, and the impact of the entity's past behaviour on customer expectations. These judgements increase the risk that the management of an entity could manipulate its profits. Adherence to the ACCA ethical code is, therefore, vital.
- Variable consideration should be included in the transaction price if it is highly probable that a significant reversal in the amount of cumulative revenue recognised to date will not occur. This may involve making judgements about whether performance related targets will be met.
- The transaction price must be allocated to distinct performance obligations, based on observable, standalone selling prices. However, estimation techniques must be used if observable prices are not available.

- If a performance obligation is satisfied over time, revenue is recognised based on progress towards the completion of the performance obligation. There are various ways to measure completion, using either input or output methods, and the entity must determine which one most faithfully represents the transaction.
- If a performance obligation is satisfied at a point in time, the entity must use judgement to ascertain the date at which control of the asset passes to the customer.

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