

IFRS 15 - Revenue from Contracts with Customers

Impact of its application

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1.0 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 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.

IFRS 15 establishes a comprehensive framework for determining when to recognise revenue and how much revenue to recognise. The core principle in that framework is that a company should recognise revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

To recognise revenue, a company would apply the following five steps:

Step 1: Identify the contract(s) with the customer.

A contract is an agreement between two or more parties that creates enforceable rights and obligations. A company would apply IFRS 15 to each contract with a customer that has commercial substance and meets other specified criteria. One criterion requires a company to assess whether it is probable that the company will collect the consideration to which it will be entitled in exchange for the promised goods or services. In some cases, IFRS 15 requires a company to combine contracts and account for them as one contract. IFRS 15 also specifies how a company would account for contract modifications.

Step 2: Identify the performance obligations in the contract.

Performance obligations are promises in a contract to transfer to a customer goods or services that are distinct. In determining whether a good or service is distinct, a company considers if the customer can benefit from the good or service on its own or together with other resources that are readily available to the customer. A company also considers whether the company's promise to transfer the good or service is separately identifiable from other promises in the contract. For example, a customer could benefit separately from the supply of bricks and the supply of construction labour. However, those items would not be distinct if the company is providing the bricks and construction labour to the customer as part of its promise in the contract to construct a brick wall for the customer. In that case, the company has a single performance obligation to construct a brick wall. The bricks and construction labour would not be distinct goods or services because those items are used as inputs to produce the output for which the customer has contracted.

Step 3: Determine the transaction price.

The transaction price is the amount of consideration to which a company expects to be entitled in exchange for transferring promised goods or services to a customer. Usually, the transaction price is a fixed amount of customer consideration. Sometimes, the transaction price includes estimates of consideration that is variable or consideration in a form other than cash. Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved. Adjustments to the transaction price are also made for the effects of financing (if significant to the contract) and for any consideration payable to the customer.

Step 4: Allocate the transaction price.

A company would typically allocate the transaction price to each performance obligation on the basis of the relative stand-alone selling prices of each distinct good or service. If a stand-alone selling price is not observable, the company would estimate it. Sometimes, the transaction price may include a discount or a variable amount of consideration that relates entirely to a specific part of the contract. The requirements specify when a company should allocate the discount or variable consideration to a specific part of the contract rather than to all performance obligations in the contract.

Step 5: Recognise revenue when a performance obligation is satisfied.

A company would recognise revenue when (or as) it satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). A performance obligation may be satisfied at a point in time (typically for promises to transfer goods to a customer) or over time (typically for promises to transfer services to a customer). For a performance obligation satisfied over time, a company would select an appropriate measure of progress to determine how much revenue should be recognised as the performance obligation is satisfied.

1.1 Reason for issuing the IFRS

Revenue is an important number to users of financial statements in assessing an entity's financial performance and position. However, previous revenue recognition requirements in IFRS provided limited guidance and, consequently, the two main revenue recognition Standards, IAS 18 and IAS 11, could be difficult to apply to complex transactions. In addition, IAS 18 provided limited guidance on many important revenue topics such as accounting for multiple-element arrangements.

1.2 A better model for revenue recognition

- (a)** Removes inconsistencies and weaknesses in previous revenue requirements;
- (b)** IFRS 15 addresses those deficiencies by specifying a comprehensive and robust framework for the recognition, measurement and disclosure of revenue;
- (c)** Improves comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;
- (d)** Reduces the need for interpretive guidance to be developed on a case-by-case basis to address emerging revenue recognition issues; and
- (e)** Provides more useful information through improved disclosure requirements.

1.3 New Disclosure requirements

Disclosure requirements

One of the Board's main objectives during the Revenue project was to improve disclosure requirements to provide more useful information to investors. To help achieve this objective, the Board held many discussions with these stakeholders. In general, investors asked for better disclosures about revenue and how revenue relates to other information in the financial statements. In addition, because of the polarised views that preparers and investors held with regard to the level of disclosure that is appropriate, the Board held several workshops in which both parties discussed the proposed requirements together. These discussions proved helpful in informing the Board's redeliberations and ultimately, the final Standard.

Compared with existing guidance, the disclosure requirements in IFRS 15 have clearer objectives and will improve the disclosure of information about a company's revenue. This cohesive set of requirements will better explain the relationship between revenue and other line items in the financial statements by requiring:

- ❖ a disaggregation of revenue into meaningful categories (e.g. type of good or service, geographical regions);
- ❖ information about a company's rights to consideration and obligations to transfer goods or services (known in IFRS 15 as contract assets and contract liabilities, respectively) and when those rights and obligations convert to revenue, and, the reasons for changes in those balances during the period;
- ❖ quantitative or qualitative information about when remaining performance obligations (a metric similar to some 'backlog' disclosures) are typically satisfied and the amount of the transaction price that is allocated to remaining performance obligations in the contract; and
- ❖ more information about the estimates and judgements a company makes in determining the amount and timing of revenue recognition—for example judgements made about the timing of the satisfaction of performance obligations, or methods, inputs and/or assumptions used when determining the transaction price.

2.0 What will change from existing practice

Before IFRS 15 was issued, inconsistencies and weaknesses in revenue Standards often resulted in companies accounting for similar transactions differently, which led to diversity in revenue recognition practices. By replacing those requirements with a comprehensive framework, contracts with customers that are economically similar will be accounted for on a consistent basis. However, the previous diversity in revenue recognition practices will mean that the nature and extent of the changes will vary between companies, industries and capital markets. Consequently, the requirements in IFRS 15 will result in changes in the accounting for certain revenue transactions for some companies.

The effect that those changes have on the amount and timing of revenue recognition will differ depending on the company, the transaction, the sector and the jurisdiction. For many contracts, such as many straightforward retail transactions, IFRS 15 will have little, if any, effect on the amount and timing of revenue recognition. For other contracts, such as long-term service contracts and multiple-element arrangements, IFRS 15 could result in some changes either to the amount or timing of the revenue recognised by a company and those changes could be significant.

2.1 Sectors most likely to be affected

Construction and Real Estate Sector

For entities in the construction and Real Estate Sector, the following areas may be of particular significance:

- ❖ Is revenue recognised at a point in time, or over a period of time?
- ❖ If revenue is recognised over time, how should progress towards completion be measured and recognised?
- ❖ Will a contract need to be ‘unbundled’ into two or more components? Alternatively, will two or more contracts need to be ‘bundled’ into a single overall obligation?
- ❖ How should contracts which include variable amounts of consideration be dealt with?
- ❖ Should costs associated with obtaining a contract be capitalised, or expensed immediately?
- ❖ What adjustments are required for the effects of the time value of money (a ‘financing component’)?

Performance obligations satisfied over time

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

(a) the customer simultaneously receives and consumes the benefits provided by the entity’s performance as the entity performs;

(b) 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

(c) 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 .

Performance obligations satisfied at a point in time

If a performance obligation is not satisfied over time, an entity satisfies the performance obligation at a point in time.

Construction Industry

i. How to account for revenue: over time or at a point in time

For contracts that meet the definition of a construction contract, under IAS 11, an entity recognises revenue and profits over time by reference to the stage of completion of the contract activity.

With the application of IFRS 15, careful assessment against criteria is required to determine if revenue and profit can be recognised progressively over time. Unlike IAS 11, progressive revenue recognition is not the automatic accounting treatment for all construction contracts. If none of the criteria to recognise revenue progressively are met, then the entity recognises revenue when it transfers control of the good or service to the customer, which may not be until practical completion

Although there is no automatic right to progressive revenue recognition, performance obligation to provide construction services will generally be satisfied over time. Customers often control the assets as they are created or enhanced. In addition, contractors will often have contractual and practical limitations on transferring the assets to another customer and will have the right to collect costs incurred and a reasonable profit margin from the customer if the customer cancels the contract for reasons other than the entity's non- performance.

For transactions currently accounted for using the stage of completion method, it will be necessary for management to evaluate contracts against the new criteria to establish whether it is appropriate to recognise revenue over time or at a point in time. If the contract arrangements do not permit revenue to be recognised progressively, then revenue is recognised at a specific point in time on transfer of control, which for a construction contract will likely to be closed to completion. Entities need to consider the structure of their construction contracts and the potential impact this may have on revenue and profit recognition.

ii. How should a contractor measure contract progress?

Contract revenue and profit are recognised with reference to the stage of completion. Examples of acceptable methods to measure stage of completion include

- contract costs incurred to date as a percentage of total forecast costs;
- surveys of work performed; and
- physical completion.

Under IFRS 15, if the requirements to recognise revenue over time are met, an entity measures progress to satisfaction of the performance obligations using a method that depicts performance. This may be either:

- an input method (e.g. contract costs incurred to date as a percentage of total forecast costs); or
- an output method (e.g. surveys of work completed to date).

A contractor applying an input method excludes the effect of any inputs that do not depict its performance in transferring control of goods or services to the customer. For example, when using a cost-to-cost method, the contractor would exclude unexpected amounts of wasted materials, labour and any uninstalled materials.

Whilst there appears to be no difference in the available methods for determining the amount of work completed to date and the revenue to be recognised under IFRS 15, the contractor needs to determine whether an input or output method appropriately depicts its performance under the contract. Therefore, some contractors may need to change methods used to measure progress under IFRS 15, resulting in either a deferral or acceleration of revenue and profit compared to current practice.

iii. Loss - making contracts

IAS 11 prescribed how to account for foreseeable contract losses. This guidance is not contained in IFRS 15 and accordingly loss-making projects are now accounted for as ‘onerous’ contracts under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. This change could have an impact on when losses from loss-making projects are recognised and how they are measured.

iv. Other areas where the construction contract will be affected

The application of IFRS 15 will also have an impact on pre-contact cost; contract accounting; costs that qualify for capitalisation; measurement of variable consideration; accounting for contract modification. IFRS 15 contains guidance on how to treat the areas mentioned above.

Residential real estate

Because of a lack of clear and comprehensive guidance, some companies that sell residential real estate in multi-unit developments have had difficulty with applying existing IFRS revenue requirements to the construction of real estate. In particular, those companies have had difficulty with determining whether the construction of such assets should be accounted for as a service (and, hence, revenue is recognised over time) or as the sale of a good that occurs when construction is complete (and, hence, revenue is recognised at that point in time). IFRS 15, however, specifies a clear and objective basis for assessing whether revenue should be

recognised at a point in time or over time. Consequently, companies in this sector are more likely to apply IFRS 15 early.

A company will be able to recognise revenue over time only if the criteria specified in IFRS 15 are met. In all other cases, a company will recognise revenue at the point in time when the customer obtains control of the promised good or service.

Telecommunications

When a contract provides a customer with both a mobile phone and network services, widespread existing practice is to recognise revenue on the sale of the phone only up to the amount of cash received from the customer at that time. Consequently, if the customer was provided with a 'free' phone, no revenue would be recognised at that time even though the customer pays for the phone as part of the monthly payments under the contract.

An entity in the telecommunications industry enters into a contract with a customer to provide a handset and monthly network service for two years. The network service includes up to 1,000 call minutes and 1,500 text messages each month for a fixed monthly fee. The contract specifies the price for any additional call minutes or texts that the customer may choose to purchase in any month. The prices for those services are equal to their stand-alone selling prices.

The entity determines that the promises to provide the handset and network service are each separate performance obligations. This is because the customer can benefit from the handset and network service either on their own or together with other resources that are readily available to the customer in accordance with the criterion in paragraph 27(a) of IFRS 15. In addition, the handset and network service are separately identifiable in accordance with the criterion in paragraph 27(b) of IFRS 15 (on the basis of the factors in paragraph 29 of IFRS 15).

The entity determines that the option to purchase the additional call minutes and texts does not provide a material right that the customer would not receive without entering into the contract (see paragraph B41 of IFRS 15). This is because the prices of the additional call minutes and texts reflect the stand-alone selling prices for those services. Because the option for additional call minutes and texts does not grant the customer a material right, the entity concludes it is not a performance obligation in the contract. Consequently, the entity does not allocate any of the transaction price to the option for additional call minutes or texts. The entity will recognise revenue for the additional call minutes or texts if and when the entity provides those services.

Automotive industry - Incidental obligations and sales incentives

Some companies may not separately recognise revenue for the transfer to the customer of goods or services that some consider to be sales incentives or otherwise incidental or ancillary to the other promised goods or services in the contract. That practice results in a company recognising all of the transaction price as revenue even though it has remaining performance obligations to satisfy. This sometimes occurs in the automotive industry when a manufacturer sells a car along with an incentive such as maintenance that will be provided at a later date.

A company will assess whether the promised goods or services arising from incidental obligations and sales incentives are goods or services that are distinct. If the goods or services are distinct, the company will recognise revenue when (or as) each distinct good or service is transferred to the customer.

Software industry

For some contracts, revenue requirements preclude a company from recognising revenue on the transfer of a good or service to a customer if there is no observable evidence of the stand-alone selling prices of each of the goods or services promised in the contract. This often results in the deferral of revenue recognition because revenue could not be recognised when the first of the promised goods or services transfers to the customer. This regularly occurs in the software industry when observable prices are not available for upgrades and additional functionality for computer software.

If observable prices of the promised goods or services are not available, a company would allocate the transaction price on the basis of estimated stand-alone selling prices of those goods or services. The company will recognise revenue as each distinct good or service is transferred to the customer.

2.2 Other areas which will be affected

Licences of intellectual property

The revenue recognition guidance on accounting for licences of intellectual property is broad. Different interpretations of that guidance have led to significant diversity in the accounting for licences.

IFRS 15 provides application guidance on how to apply the revenue framework to different types of licences of intellectual property.

Estimates of variable consideration

Revenue requirements do not include detailed guidance for measuring the amount of revenue that should be recognised when the consideration is variable.

If the consideration promised by a customer is variable, a company will estimate it using either the expected value or the most likely amount, depending on which amount better predicts the amount of consideration to which the company will be entitled. Some or all of the estimated amount of variable consideration is included in the transaction price only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

Significant financing components

If a customer pays for goods or services in advance or in arrears, some companies may not consider the effects of any financing components in the contract when determining the amount of revenue to be recognised.

A company is required to consider the effects of any significant financing components in the determination of the transaction price (and thus the amount of revenue recognised). This may affect long-term contracts in which payment by the customer and performances by the company occur at significantly different times.

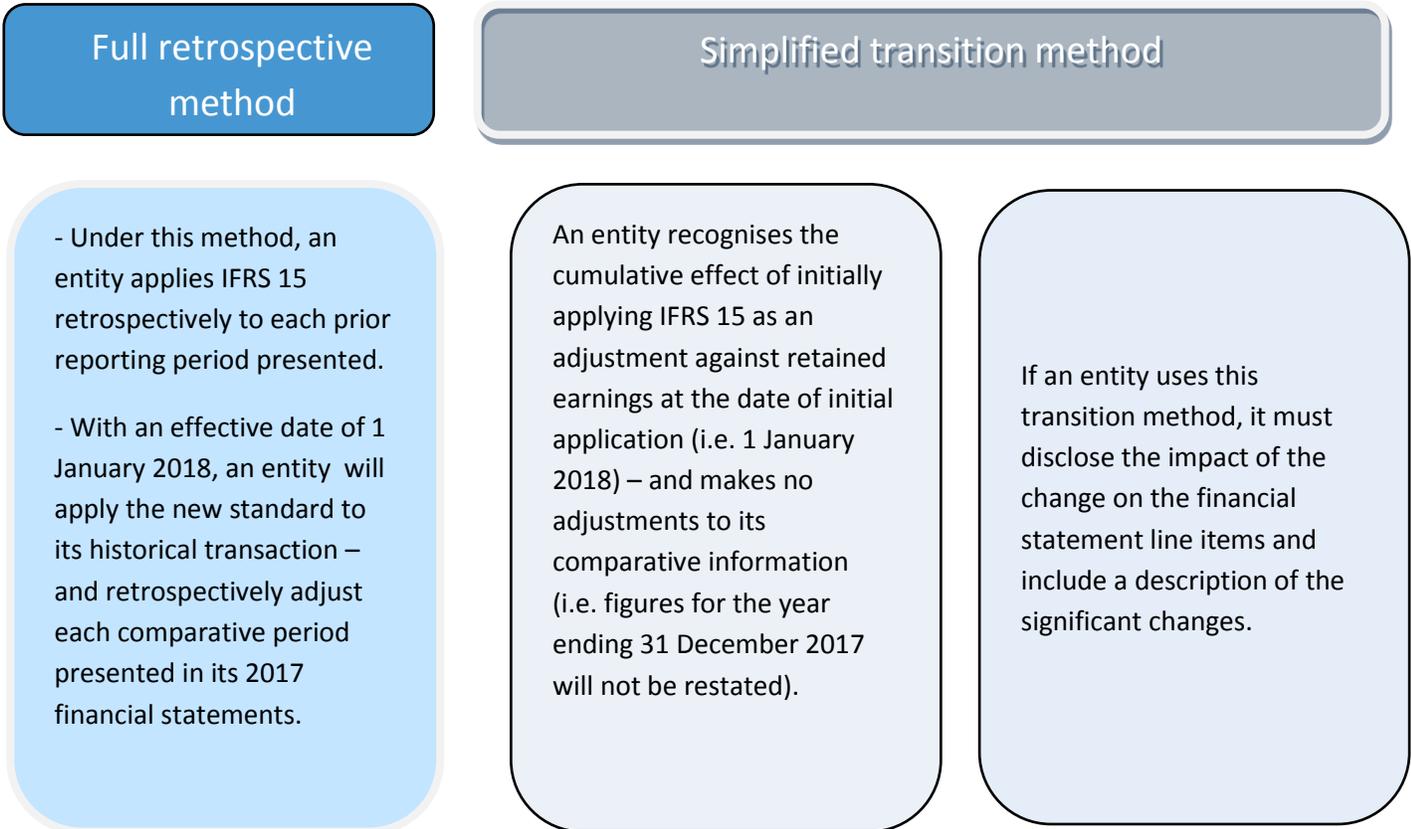
3.0 Effective date

An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted. If an entity applies this Standard earlier, it shall disclose that fact.

4.0 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:



		PY2 (2016)	PY1 (2017)		CY (2018)	CY footnotes
Retrospective (with optional practical expedients)	Cumulative catch-up	Contracts under new standard				
Cumulative effect at date of application		Contracts not restated		Cumulative catch-up	Existing* and new contracts under new standard	Existing and new contracts presented under legacy IFRS/US GAAP

4.1 Ease of transition

The aim of the simplified transition method is to reduce the transition time and effort for preparers that choose this option. The requirement for entities to disclose the impact of each financial statement line item will effectively result in an entity applying both IFRS 15 and the previous revenue Standards in the year of initial application.

4.2 Transition Resource Group (TRG)

After issuing IFRS 15 and Topic 606, the IASB and the FASB have formed a joint group of external stakeholders to identify and discuss issues that may arise in the implementation of IFRS 15 and Accounting Standards Update. The TRG has published a paper on the website of FASB, named 'Revenue Recognition - Potential Changes to US GAAP', elaborating on the changes in the revenue recognition standard. The following link refers:

http://www.fasb.org/cs/ContentServer?site=FASB&c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176159791236

5.0 Planning and preparation required in the implementation of IFRS 15

The adoption of IFRS 15 may lead to significant changes in the pattern of revenue and profit recognition. Careful consideration and planning will be needed for a wide range of issues, including:

A review of the terms and conditions of existing contracts will be needed (in particular long term contracts which extend into periods covered by financial statements affected by the adoption of IFRS 15) as well as those which are to be entered into in future. In some cases, entities may wish to consider whether changes should be made to contracts.

Whilst revenue recognition similar to stage of completion accounting under IAS 11 is retained under IFRS 15, the criteria to achieve this outcome have changed. Contractors will need to consider their contractual terms to assess whether they can continue to recognise revenue overtime, as failure to do so may lead to significant deferral of revenue. Entities in the construction Industry should therefore look at their current processes and identify further gaps exist in respect of the enhanced disclosure requirements.

It is also likely that sales departments will need to liaise more closely with the accounting department in future, in order that the effects of any proposed contractual terms on the related financial statements can be understood in advance. It is possible that new and/or modified internal processes will be needed in order to obtain the necessary information.

References:

IFRS 15 Revenue-from-Contracts-Project-summary-Feedback-Statement-May-2014 (IASB)

Investor Perspectives—June 2014 (IASB)

Impacts on construction industry of the new revenue standard – KPMG September 2014

IFRS Industry issues - BDO