IFRS 15:Revenue from Contracts with Customers

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IFRS 15: Revenue from Contracts with Customers

The principle in the standard will be applied using a five step model

Step 1

Identify the contract with a customer

Step 2

Identify the performance obligations (PO) in the contract

Step 3

Determine the transaction price (TP)

Step 4

Allocate the TP to the PO in the contract

Step 5

Recognize revenue when (or as) an entity satisfies a PO

Two ways of adopting IFRS 15

- Entities are allowed to choose whether to apply IFRS 15 retrospectively to each prior period presented (with optional practical expedients) or retrospectively with the cumulative effect of initially applying IFRS 15 recognised at the date of initial application.
- Under the retrospective application, an entity restates its prior period comparatives in the financial statements as if the guidance had existed.
- Under the alternative transition method, restatement of comparative years is not required but the cumulative effect of initially applying IFRS 15 should be recognised as an adjustment to the opening retained earnings on the effective date (in the year of initial application). Additional disclosures are then required to illustrate the effects of applying the standard.

Illustration – contracts with customers

	Contract Term	Retrospective approach	Modified Approach
Contract X	1 January 2015 to 31 December 2021	Adjust the opening balance of each affected component of equity in the balance sheet for the earliest prior period presented.	Adjust the opening balance of each affected component of equity at initial application and make the required disclosures. 2017 figures are not restated
Contract Y	1 January 2016 to 31 December 2017	Adjust the opening balance of each affected component of equity in the balance sheet for the earliest prior period presented.	Contract completed before effective date therefore do not apply IFRS 15.
Contract Z	1 January 2018 to 31 December 2018	Practical expedient available as it begins and ends in the same annual reporting period.	Contract completed before effective date therefore do not apply IFRS 15.

Implementation Strategy for the adoption of IFRS 15

- ❑ **Assess the impact of IFRS 15 on your business before embarking on the implementation phase**
- ❑ **Assign senior resources to lead the effort**

When making these strategic decisions, the senior resource must be capable of identifying changes that might occur with existing revenue arrangements, contract terms and on business practices for the entity. Identify the changes when considering the following questions:-

- ✓ Will the entity have to re-consider customer negotiations?
- ✓ Should the entity re-consider the way in which it sells its products to customers ?
- ✓ How would compensation and benefit plans be structured?
- ✓ What information does the entity need to communicate to its investors and other stakeholders?

Implementation Strategy for the adoption of IFRS 15

- **Involve IT department**

Software may need to be updated or procured as it may not be capable of being customized to capture new information that was not necessary before. To facilitate this challenge, the IT department will be involved as they may need to modify, reconfigure or even implement new information systems for the entity.

- **Assess in-house resource allocation and competency**

A cost-benefit analysis should be performed to identify the following:

- ✓ Does the entity have the resources to apply the new standard?
- ✓ Based on the resources that the entity has on hand, will it be more effective for the entity to apply one method over the other?
- ✓ What does the entity's investors expect and does the entity still have the resources to meet their expectations?

Aspects of the business that may be affected by the transition

- **Training for employees:** entities should provide training to those employees affected by the changes. This will include accountants, internal auditors and those responsible for drawing up customer contracts.
- **Systems and processes:** as noted previously, in order to gather the information required for reporting under IFRS 15, an entity may require re-designs or modifications to its IT systems and its processes
- **KPIs**: where they are based on a reported revenue or profit figure, they may be impacted by the changes. As such, an entity may want to begin evaluating the impact of the standard on key financial ratios and performance indicators that may be significantly impacted by the changes with a view to determining whether its KPI targets should be adjusted. Where there are changes, an entity will also need to consider how to explain these to investors.

Aspects of the business that may be affected by the transition

- **Compensation and bonus plans**: bonuses paid to employees are sometimes dependent on revenue or profit figures achieved. Changes in the recognition of revenue as a result of IFRS 15 may have an impact on the ability of employees to achieve these targets
- **Tax**: the profile of tax cash payments and the recognition of deferred tax, could be impacted due to differences in the timing of recognition of revenue under IFRS 15.
- **Stakeholders:** users of the financial statements such as the board of directors, audit committee, analysts, investors, creditors and shareholders will require an explanation of the changes in IFRS 15 in order to understand how the financial statements have been impacted.
- **Ability to pay dividends**: the ability to pay dividends to shareholders is impacted by recognized profits, which in turn are affected by the timing of revenue recognition.

Collaboration with the various stakeholders

- Some trainings have been carried out by ICPAK on IFRS 15
- Requirement in place in various regulations for entities to report their financials as per the International Financial reporting standards(IFRS) e.g. the Insurance Act.
- Most entities are currently assessing the impact of IFRS 15 on their business before embarking on the implementation phase .

Conclusion

- IFRS 15 introduces a new model for revenue recognition with a single principle that applies to all contracts.
- Almost all entities that generate revenue will be affected by the issue of this new standard as it may result in substantial changes to the timing and measurement of revenue recognition, and introduces significantly revised disclosure requirements.
- Entities should assess the impact of the standard and the changes that will be required before implementation.